The Extractive Industries Transparency Initiative (EITI) aims to encourage the responsible use of revenues from the exploitation of natural resources in order to promote sustainable development. Transparency regarding the revenue streams is to support the improvement of public financial management as citizens can more easily hold their governments accountable. Governments are thus supposed to distribute the revenues they gain from natural resources to the benefit of their citizens and in the interest of national development (Ray and McMillin, 2003).

Civil society is explicitly included in the EITI process to spur public debate and raise awareness regarding the substantial amounts of money available as a first step to empowerment (Ray and McMillin, 2003). In developing the EITI, stakeholders found that a voluntary mechanism to disclose revenue streams would be the most effective means to contribute to aid political as well as economic stability, to curb corruption and ultimately to stimulate democratization (Ray and McMillin, 2003).

The good governance – stability nexus is particularly interesting with regards to fossil fuel exporting countries; those, which the EITI was aimed at in the first place, as in these cases, the initiative enhances global energy security (Ray and McMillin, 2003).

A main issue of global debate during the time when the EITI was first proposed, that is one year after 9/11 in the wake of the fight against terror, was the relationship between the bad governance of weak states and terrorism. This indicates that the security dimension is particularly important for the EITI. Terrorism was perceived to originate first and foremost in energy exporting countries respectively to be financed through oil money. Improving governance and financial management, thus aiding sustainable development, in these countries through enhanced governmental accountability was meant to increase stability (Ray and McMillin, 2003) and to curb extremism.
Two questions regarding the impact of the EITI arise, namely: 1) Does the EITI curb corruption and enhance a government’s accountability towards its citizens? And 2) Does the EITI increase stability by improving transparency?

This paper aims to answer these questions in the following steps: First, transparency, corruption and governance are understood from a theoretical point of view. The concepts are then transferred into the context of the first EITI compliant country in the world – Azerbaijan. In a third step the EITI's output is analyzed and its impact on transparency of the revenue flows from the exploitation of natural resources and accountability is assessed. Finally, the EITI's impact in Azerbaijan is considered and explained.

The question of stability of energy exporting countries is once again of great significance, because of the Arab Spring that has swept over North Africa and parts of the Arabian Peninsula. It is assumed that while the EITI's effect on accountability is very limited, it does indeed aid stability, although not necessarily by triggering good governance.

The paper draws mostly on publicly available information, because in energy, “real” numbers are hard to come by and those numbers referred to here have been validated by internationally recognized auditors. In most cases, the level of payments and the mechanisms to distribute them are more significant, than their perfect accuracy.

**Theory**

This chapter defines transparency and corruption and introduces how the concepts are linked to governance. Transaction cost and social norms are found to form the link between transparency and governance respectively between corruption and governance.

**Transparency**

The “right to know” implied with transparency initiatives is not only being discussed since the publication of secret documents on Wikileaks 2011. Instead, there is a broad debate in literature about the virtue of transparency since it became popular in the 1990s (Heald, 2006, p. 40). Finel and Lord define transparency as “mechanisms that facilitate the release of information about policies, capabilities, and preferences to outside parties” (Finel and Lord, 1999, p. 315) in general and for states with a focus on the internal characteristics of government (Finel and Lord, 1999, p. 316). They found that while transparency does affect the amount of information available, it does not aid in its interpretation or in the assessment of ambiguous information (Finel and Lord, 1999, p. 317). In foreign policy, transparency therefore may exacerbate crises (Finel and Lord,
1999, p. 335). Transparency can also be interpreted “to provide a substitution for government regulations” (Etzioni, 2010, p. 391), such as for example product standards. It then is a neo-liberal concept that lends very high importance to the market and individual decisions. In this case, transparency is criticized, because ultimately the amount of information people would have to process in order to make good decisions exceeds their capacity to do so.

However, in this paper transparency shall signify “the conduct of business in a fashion that makes decisions, rules and other information visible from outside” (Hood, 2010, p. 989). It functions as a mechanism for public control of procedures of corporate and state governance (Heald, 2006). Consequently, the “lack of transparency in rules, laws, and processes creates a fertile ground for corruption” (Tanzi, 1998, p. 575). As Virginia Haufler points out, “activism surrounding transparency in resource management is aimed at the most difficult countries to penetrate, and those with the most severe governance problems.” (Haufler, 2010, p. 58) Accountable governance is yet more complex than just transparency.

While it is recognized that transparency addresses the availability of information, it is unclear under what conditions this has an effect on the behavior of authoritarian governments (Hood, 2010, p. 991, 995). At the transnational level, according to Hale, transparency institutionalizes public discourse, because “the act of disclosure begins a dialogue between the discloser and interested parties” (Hale, 2008, p. 85). It furthermore enhances the credibility of discussions and through uncovering lies makes norm compliance more probable (Hale, 2008, p. 86; Hood, 2010 #1114: 992). Regarding the flow of information, Heald differentiates between upward transparency that allows principals to control their agents and downward transparency, which he equates with accountability, as it refers to the public overseeing its rulers (Heald, 2006, p. 27). He further distinguishes between outwards and inwards transparency, meaning respectively the flow of information into (from the outside) and out of (allowing outsiders to observe what is going on inside of) an organization (Heald, 2006, p. 28). Heald notes that “[f]or transparency to be effective, there must be receptors capable of processing, digesting, and using the information” (Heald, 2006, p. 35). This appears to be crucial in the context of corrupt governments and weak civil societies.

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1 Presumably, the public would be conceptualized outside government and administration which can be understood as organizations. Therefore, the distinction between upward and inwards transparency is not clear.
Corruption

Most papers on corruption go some lengths to define the elusive concept (Husted, 1994, p. 18; Tanzi, 1998, p. 564–565; Staffhorst, 2010, p. 28ff; Bardhan, 1997, p. 1320f., 1334). As no operationalization of the concept is intended here, the following broad definition shall suffice: “Corruption is a social interaction between individual actors in the function of principal and agent which is extended to cover a personal and particularistic barter against universal expectations.” (Höffling, 2002, p. 24) Banfield distinguishes between personal and official corruption. “An agent is personally corrupt if he knowingly sacrifices his principal's interest to his own, that is, if he betrays his trust. He is officially corrupt if, in serving his principal's interest, he knowingly violates a rule, that is, acts illegally or unethically albeit in his principal's interest” (Banfield, 1975, p. 587f). In order to analyze and assess the workings of transparency against corruption, the mechanisms of corruption need to be specified. Weißenberg remarks that the misuse of (public) power probably exists since there is public power (Weißenberg, 2003, p. 1) but the analysis needs to go beyond the resource-curse literature and beyond notions of path-dependency.

Generally, studies on corruption establish its pervasiveness and stickiness (Ashforth and Anand, 2003). Corruption seems to be a fast spreading disease (Tanzi, 1998, p. 562; Gelman, 2012) that perverts the makeup of social relations (Tanzi, 1998, p. 586). If the majority of the members of an organization breaks the implicit rules or accepts others’ violations of those rules, a “permissive ethical climate” develops (Ashforth and Anand, 2003, p. 5) and collective deviance ends social control (Staffhorst, 2010, p. 44). A subculture of rule-breaking develops (Staffhorst, 2010, p. 45) and corruption is “normalized”. Transition literature describes this phenomenon for the late years of the Soviet Union and argues that it is the result of inefficient rules. It is, however, also a reason for the inefficiency of rules.

Corruption has a stronger potential to be widely accepted (Ashforth and Anand, 2003, p. 2) than, say, violent crimes, because it is a white collar crime without direct victims (Matei and Matei, 2011, p. 9), despite its potentially devastating effects on society. As it may appear to be venial, collective corruption can become stable, repetitive and largely unquestioned - thus systemic (Staffhorst, 2010, p. 41; Ashforth and Anand, 2003, p. 37). Once corruption is accepted, goals that require rule-compliant behavior can no longer be reached. In this situation the structural conditions in an organization prevent the realization of values independently of the individual motivation: The norms within an organization are transformed so that they fit the new structural realities and a subculture forms among individuals who, in spite of their awareness regarding the culpability of their action, accept corruption - if not unquestioned then at least as justifiable (Staffhorst, 2010, p. 45). Obviously, new or better rules cannot change behavior in such a situation.
From a game theoretic point of view, rule-defiant action almost always yields rents\(^2\). In the face of the underlying conceptualization of the rational self-interested homo oeconomicus one would expect constant rule-defying action or chaos. If corruption proves successful once, it survives, because individuals tend to judge practices not based on ethics but on success (Ashforth and Anand, 2003, p. 15).

The link between transparency and corruption & governance

Governance is understood as the management of processes and people to politically defined ends. It necessarily follows rules and creates rules by being performed. Governance thus institutionalizes decisions, if institutionalization is defined as the process that translates ideas into practice. Governance is no end in itself, but a means. The guiding questions for this section are thus: How are the effectiveness and efficiency of governance influenced by transparency respectively corruption? Is corruption the default human behavior and if so, how can transparency be institutionalized in governing organizations?

The primary link between governance and corruption / transparency is transaction cost. The notion of transaction cost was established to explain how regular and predictable behavior is rationally favorable in the long-term, especially in reoccurring interactions and fixed relationships. The transaction cost approach assumes a rational, opportunistic, rent maximizing homo oeconomicus. However, an actor’s rationality is limited by the availability of information and his ability to process information (Husted, 1994, p. 19; Scharpf, 2000, p. 319, 72, 75f; Crouch, 2003, p. 72). “Transaction cost” in this sense\(^3\) denominates investments in the acquisition and analysis of information on the present and future. Transaction costs are obviously influenced by other people’s willingness to disclose information (transparency). Furthermore, information is unevenly distributed amongst contract partners and therefore any transaction, including corruption, requires trust and/or safeguards (Husted, 1994, p. 19). Transaction costs are obviously increased in secretive environments where people do not follow common rules. Ordinary methods to ensure compliance in corruptive transactions are incentive alignments, private ordering, and trading regularities. They are vital since the parties do not have recourse to the legal system. To fight corruption, Husted recommends policies that tackle those safeguards (Husted, 1994, p. 26).

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2. If the other players stick to the rules.

3. Transaction cost also refers to the specificity of assets and knowledge thus the cost of using something or someone for a new or unintended purpose.
Formal institutions make governance more predictable and rational as they lay out procedures and assumptions regarding causalities. This, however, only makes sense if rule compliance is understood as a social phenomenon, or, if formal institutions are guiding action. To understand the dynamics of corruption it, too, has to be interpreted as an individual act, as well as a social phenomenon that undermines, changes or is an institution (Staffhorst, 2010, p. 50ff.). Corruption is not purely rational and thus easily overcome by better “fitting” rules and incentives (Bardhan, 1997, p. 1335), but it is also a point of view that affects an organization as a collective. Therefore, the question is how rules to tackle corruption can be implemented.

Transaction cost approaches ignore reasons for and against corruption beyond pure self-interest (Staffhorst, 2010, p. 48). They imply that the complete commercialization of the chain of command would be an effective means to govern. Yet, it has been shown that within organizations it is not solely salaries that motivate employees. Far from it: Research suggests that employees need a degree of autonomy to develop a sense of responsibility and engage emotionally (identify) with their employer (Young, 1999). Staffhorst aims to conceptualize an approach which allows the implementation of sustentative non-economic guiding ideals in a rational organization as a part of effective modern management (Staffhorst, 2010, p. 17). She investigates the question how management can guarantee that all actors on different levels individually use criteria of rationality which are in the interest of the whole organization (Staffhorst, 2010, p. 18f) see also (Young, 1999). For her, institutions are dynamic, unwritten rules or values that can become or cease to be general practice - thus becoming institutionalized or deinstitutionalized through social processes (Staffhorst, 2010, p. 19). Analytically, Staffhorst differentiates between the national culture and the culture of an organization (Staffhorst, 2010, p. 20). Although the inner and outer value set of an organization interact, conflicting rules trigger decisions about loyalty. Norms show when deviant action is not only discovered but discussed (Staffhorst, 2010, p. 20). An important characteristic of economic organizations is their hierarchic structure, and hence multiple principal-agent relationships (Staffhorst, 2010, p. 37). Yet, to effectively fulfill its purpose, an organization needs its members to discipline each other - social control (Berger and Luckmann, 1991; Hollinger and Clark, 1983).

The process that makes organizations suffer from corruption is generalizable beyond organization or culture (Ashforth and Anand, 2003). Interestingly, studies on the proliferation of corruption (Staffhorst, 2010; Weißenberg, 2003; Höfling, 2002, p. 78, 176) and on the (global) diffusion of transparency and good governance describe the same thing - only from different angles. Whereas corruption appears to be (informally) institutionalized by action, transparency is a norm that is supposed to lead to action.
First and foremost, norms, like ideas, spread by being discussed (McNeill, 2006; Payne, 2001). Norms are "shared (social) understandings of standards for behaviour" (Klotz, 1995, p. 451). Norms always denote something that a group of people deems desirable (Clapp and Swanston, 2009) (like "be law-abiding", "be successful", "be strong"). Once something is accepted as "good", it becomes part of the identity of people or is at least formally endorsed. This is true for individuals as for organizations and can lead to minor as well as major changes (Sandholtz and Gray, 2003, p. 761). The verbal or formal endorsement of a norm might not directly change practice, but it gives those actors that do believe in the norm leverage (Elgström, 2000, p. 472f) and helps to create an "enabling environment".

Unlike corrupt practices, formal institutions are impersonal and require trust in the broader society, rather than constituting a reciprocal direct dependency. At the same time, formal institutions facilitate more efficient and effective government than the multitude of relations involving few individuals that marks corruptive networks, because the costs of enforcement are to a large degree externalized and transaction cost are lower. Transparency and corruption can, in this sense, be understood as different forms of governance, with the first being more efficient, long-term and hence, ultimately, more stable.

**Azerbaijan**

This chapter provides a brief overview about the current governance practice in Azerbaijan. Based on more general considerations of rents as motivation for opportunistic action, this chapter draws on contemporary research on Azerbaijan to sketch the state of corruption in society.

The most prominent theories to describe the newly independent resource-rich states structurally both point towards severe corruption and governance issues: The political-economist “resource-curse” literature and the historical-institutionalist transition literature indicate a high likelihood for the development of inefficient states ruled by informal institutions and rent-seeking behavior. Azerbaijan has been under Soviet respectively Russian rule for 160 years in its history and the first commercial oil well was dug 163 years ago. Yet, respondents to a survey by Heradstveit in Azerbaijan remark: “Refusal to publish can only serve as evidence of corruption” (Heradstveit, 2001, p. 277). Heradstveit finds a “growing unease in Azerbaijan, a fear that the expected oil wealth will be squandered by the narrow and corrupt power elite” (Heradstveit, 2001, p. 261). Thus, even in countries that are fundamentally impacted by corruption and opportunism, people don’t think that those things are “good” and do realize that they have adverse effects on the whole of society. How does this play out in practice?
**Rents**

Rent is the central concept of the resource curse theory. It explains that because of high rents, states rich in resources are particularly susceptible to corruption, dictatorship and underdevelopment (Damania and al., 2005). Although additional resources should have a positive effect on states (Morrison, 2009), many authors find them responsible for the emergence of bad institutions (Hoopes, 1997; Robinson and al., 2006; Acemoglu and Robinson, 2006). According to theory, especially the elites of states rich in fossil fuels tend to buy public loyalty with welfare-measures (Karl, 1997, p. 49). The population is in a weak negotiating position, because only a minority of the citizens is involved in the creation of rents (Massabié, 2008, p. 40; Karl, 1997, p. 48; Schwarz, 2008, p. 215; Youngs, 2009, p. 10; Davidson, 2005, p. 89). Therefore, resource revenues are not spent in the national interest to the benefits of the majority of the citizens.

Although the resource-curse theory is very compelling, a quick regression using World Bank (The World Bank, 2010) and United Nations (UNDP, 2010) data revealed no connection between the amount of natural resource rents and human development. The level of human development as measured in the UN HDI in 1980, on the contrary, greatly accounted for the level of development in 2005. Thus, performance, not resources, explains performance. As transparency, accountability and the empowerment of civil society become increasingly accepted to improve policy, de Renzio, Gomez and Sheppard looked for empirical consistencies in “the nature and extent of budget transparency in resource-dependent countries”. They, too, failed to prove a causal connection between dependency on resources, budget transparency and human development (de Renzio and al., 2009, p. 58).

Rents can accrue from very different sources: from the export of natural resources at prices well above their production cost as well as from specific economic structures (e.g. monopolies) and, obviously, corruption. “[M]uch of the political struggle is indeed about access to those resources, since they are the lifeblood of the patronage networks that provide the structure of politics” (Simons, 2008, p. 54). In some contexts, people seem very willing to reap this kind of rents. This has led to “rapacious individualism” - the economic equivalent of Hobbes naturalistic state (Simons, 2008, p. 54f). The same egoism that drives people to do everything to get profit also prevents real profit as, in the end, no one will agree to be governed and the collective action problem becomes infinite to the detriment of everyone. Thus, while the natural resource endowment of a country does not determine its developmental path, the distribution (use) of rents seems very significant. So what determines the way rents are distributed?
Focusing on the question of change, transition literature points to the persistence of structures (Simons, 2008; Linz, 2000). While many formal structures have been altered with the break-up of the Soviet Union (or the end of colonialism), *unchanged informal structures* continue to govern the actual political and economic life in most countries (Gelman, 2012; Simons, 2008, p. 50ff). Those informal structures are based on personal exchanges that render immediate benefits to the parties involved. Communist-planned economies demanded a concentration of power in order to facilitate the control of the whole economic system (Weißenberg, 2003, p. 27). Yet, public authority was circumvented all the time to cope with the economic deficits of central planning. Thus, societies in the states of the FSU in reality neither deemed official rules relevant in spite of their multitude nor did they trust public authority (Weißenberg, 2003, p. 28). The persistence of this societal attitude towards formal institutions points to a massive governance problem and makes the transparent and efficient use of resources unlikely.

**Governance**

If politics is the competition between different ideas about where a society should go, Azerbaijan is essentially apolitical: "Indeed, a surprising element in Azerbaijani politics is the consensus that reigns in terms of ideological questions. The hegemonic position, which both the government and the main opposition forces claim to adhere to, is a commitment to the building of a secular, liberal, democratic republic where citizenship is the basis for membership in the national community." (Cornell, 2010, p. 164) While different political strata are thus ideologically similar, they are differentiated by the person most influential in them (Cornell, 2010, p. 171). The processes to establish important positions within the political parties are not democratic (Babajew, 2009, p. 207ff.) and political success depends on wealth rather than vision (Cornell, 2010, p. 175f.). If rentierism is deeply entrenched into the basic formation of opinions and decision-making on political issues, political parties function to distribute benefits. The same is true for the administration - hence accounts of the prices of different administrative posts (Schneider, 2003). In the public opinion in Azerbaijan the corrupt system is understood as a perfect pyramid, with rents extracted at the lowest level being passed on to higher echelons of power. This implies that there is but outward corruption (Ashforth and Anand, 2003, p. 40), while the commercialization of hierarchy is perfect within the administration. However,
considering the logic of corruption, it is likely that there are high costs to keeping systemic corruption centralized.\footnote{4 The degree of centralization of corruption is an important factor: Weak states become predatory because they cannot control corruption while strong states with centralized corruptive systems can provide for a certain level of development BARDHAN Pranab, « Corruption and Development », \textit{Journal of Economic Literature}, n° 35, 1997, p. 1320–1346, p. 1341.}

It has been established that rentierism can thrive under all circumstances. Rentier-states however are defined as states where the distribution of rents (or of positions which allow the extraction of rents) is the most important source of legitimacy of the rulers. Azerbaijan seems to works that way. The stability of its ruling elite is based upon its defiance of public laws (which are the basis for its power). Such a system can only exist because it forces the wider population to follow rules which its members break as part of their job description. It “comes to expect and then depend on the payoffs from corruption” (Ashforth and Anand, 2003, p. 9). Corruption serves as important factor of success and stability (Staffhorst, 2010, p. 39). As the significance of informal social control and the ethical environment for behavior have been shown (Ashforth and Anand, 2003, p. 9; Staffhorst, 2010, p. 37, 40f), it is questionable that corrupt agents can be effective principals in the long-term. Rent extraction is therefore seriously endangered by the mechanisms it depends upon as stability requires a certain number of people to actually do their jobs.

The direct payments oil companies make to the government are not necessarily the big problem for governance. The “disguised” medium-level corruption systematically hidden behind the spending of public money has much more serious consequences for the public morale. The final costs of public roads (MacDonald, 2008), railroads (CESD, 2011), schools, water systems and services are inflated because of corruption in Azerbaijan (International Crisis Group, 2010, p. 11). Service providers artificially raise the costs of material, manpower etc. to split rents within the network or transfers excess earnings directly to a public official. This form of corruption is often hard to prove for the public in any country as contracts are kept secret and the optimal cost for complex projects is difficult to calculate. Favoritism and gifts are usually exchanged within an in-group of members of the state and private individuals. When asked about the lack of entrepreneurship in Azerbaijan, people claim to refrain from opening or expanding a business, because they fear high fees and taxes if they operate legally. It is often ascertained that if a business is running well, its owners are approached by various state officials who want to enact all kinds of rules and collect a myriad of tolls or who want to buy that business.
If belonging to an organization is not defined by contract, tradition or any discernible trait but the ability to pay for a post and then to successfully extract rents from others collective action becomes unproductive (Staffhorst, 2010, p. 56). To combat this entrenched corruption, national and global initiatives have been formulated in the name of sustainable development. National measures against corruption seem to be invoked foremost to dispose of obstreperous subordinates or rivals (Pleines, forthcoming 2012, 2011). The implementation of the international EITI is now analyzed against this general theoretical and political background.

**EITI outputs**

The EITI is a global initiative which aims to increase public information regarding the amount of money a state makes from the exploitation of its minerals, metals and hydrocarbons to promote accountability and sustainable development (Ray and McMillin, 2003). As such it is dependent upon the support of the companies and governments in the sovereign countries where it is supposed to be implemented. Thus, each government and company in the extractive industry has to voluntarily join the initiative. While this voluntary character is criticized by NGOs, it is inevitable. The EITI is a political initiative that aims to improve the administration of resource-revenues. In Azerbaijan, the decision to join the EITI was taken by the president of Azerbaijan without pressure or involvement from civil society⁵.

It is said that Tony Blair first announced the EITI in a speech at the 2002 Summit of the UN Commission on Sustainable Development (UNCSD) in Johannesburg⁶. The EITI was adopted on June 17th 2003 in London at a Lancaster House Conference chaired by Tony Blair (Extractive Industries Transparency Initiative, 2011b). The initiative is intended to reverse the so-called resource curse or, more concretely, to encourage international oil and gas corporations to publish what they pay governments before and in the process of the production of oil and gas. Thus citizens shall be enabled to hold their government accountable for the money it receives (Ölcer, 2009, p. 10). The initiative is widely endorsed by governments, notably the G8 in its action plan against corruption of 2003 (Ministère des Affaires étrangères de France, 2003), and by international organizations such as the World Bank. Meanwhile, critics call for more rigorous actions against corruption. In June 2002, shortly before the EITI was proposed, George Soros

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⁵ Interview, 13.09.2011

launched the "Publish What You Pay" (PWYP) campaign which demands that all international corporations be obligated to abide by the financial reporting rules of their home-countries for all their operations, no matter where they take place (Johnson, 2003). The PWYP is endorsed by over 600 NGOs world-wide (Publish What You Pay, 2011). Other critics suggest the publication of financial flows resulting from the extraction of natural resources by itself does not help against corruption (Bosshard, 2009). For civil society to hold governments accountable, it needs the means to put pressure on the government and the knowledge to “scrutinise the figures presented in the EITI reports to know exactly how the financial organisation behind the extractive sector works […] and so on ” (Ölcer, 2009, p. 27). Often, the necessary conditions for this to happen are missing in countries where EITI success is most urgent.

This critique fits well with literature on transparency and corruption above - transparency without empowerment of the civil society does not lead to accountability. So far, no significant effect on the perception of corruption can be observed in EITI compliant countries (Ölcer, 2009, p. 10) which is not surprising, as the first country to fully comply with the EITI - Azerbaijan – was first considered compliant only in 2009 (Extractive Industries Transparency Initiative, 2011a) after having joined the initiative in 2003 (Benz, 2004). Furthermore, the initiative does not require governments to disclose what they so with the money they receive.

**How the EITI works**

The initiative follows an easy principle: Companies in the resource industry that choose to join the initiative report to an auditor how much money and resources they transfer to the host government (as bonuses, profit share, in taxes etc.). The host government likewise reports to the auditor the financial and resource flows it receives from the companies operating a resource. In Azerbaijan, which mainly possesses oil and gas, the parties report on the amount of oil and gas they transfer to the government as well as on the payments they make to the government7. The government reports on the same items. The auditor, often internationally acknowledged accounting firms (Committee on the Extractive Industries Transparency Initiative, 2003), crosschecks the reports and investigates discrepancies. The process is overseen by a multi stakeholder group, with representatives of the oil & gas companies, of the government and of NGOs as well. A consolidated report is published (see Figure 1).

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7 Recently, the revenues received from gold mining were added to Azerbaijan’s EITI report.
However, neither the profit on the sale of product nor information on investments in the fields is published under the EITI. Special confidentiality clauses are used to guarantee that certain information remains secret (Haufler, 2010, p. 60). Furthermore, if transfers are omitted from the reports both by the companies as well as the government, they cannot be discovered under the EITI.

From a theoretical point of view, the EITI can be explained as attempt to improve the governance of two distinct principal-agent relationships: The population of resource-rich countries as the owners of a natural resource (principal) who according to liberal political values should be represented by their governments (agent) and the share-holders of international oil

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8 The investments in a reservoir plus the cost of capital, together with the contractually agreed course of repayment significantly influence the distribution of the profits from resource extraction between the host-state and the investor (mainly IOCs).
companies (IOCs) (principal) who are represented by the managers of those companies (agent) (Ölcer, 2009, p. 31).

The principal-agent problem arises mainly because the elites (government) of resource-rich countries do not act in the interest of their population but in their own self-interest. Given the secrecy within the oil and gas industry, the population usually cannot check its government’s action; information is perfectly asymmetrical. Since international companies have to abide by reporting standards, their shareholders, on the other hand, can more easily obtain the most relevant information on a company’s performance. Individual shareholders as well as individual voters usually face a stark asymmetry of power on top of the information problem. However, while the first have an exit option, the latter hardly do. The elites of resource rich countries “get more rewards (formally through taxes, royalties etc. and informally through bribes) from the managers of extractive companies than from their citizens, who alone can confer legitimacy” (Ölcer, 2009, p. 32). Furthermore, the government of resource-rich countries often interacts with IOCs through a national oil company (NOC) which complicates accountability. Citizens of resource rich countries can, however, withhold loyalty form their government and this is where political stability is at stake.

The IOCs can also be regarded as agents of the host governments, because they are invited to invest in the production of natural resources for the benefit of the host government (Ölcer, 2009, p. 32). Once again, information is asymmetrical, as the operating companies have the necessary technical knowledge, which allows to profit from certain natural resources, like oil and gas in complex fields, in the first place. Without them, the host governments could not extract the resource, even if they did lever enough money to invest.

**Outputs in Azerbaijan**

In the case of Azerbaijan, production sharing agreements (PSAs) are negotiated between IOCs and the government of Azerbaijan with participation of the State Oil Company of Azerbaijan (SOCAR). The PSAs are adopted by Parliament and signed by the President to become national law. As laws have to be published in order to become effective, Azerbaijan might be the only country where most big oil and gas contracts are publically available. This is a very important

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9 Therefore IOCs can negotiate more favorable terms for their business when oil and gas production is more challenging.

context for the adoption of the EITI, as the detailed study of those PSAs and figures published by IOCs gives a fairly clear picture of the government’s direct income from those companies which are part of the EITI.

The EITI pertains to a specific part of the oil business. To understand what the EITI tells us, it helps to visualize the cash and in kind flows from Azerbaijan’s Azeri-Chiraq-Güneshli (ACG) oil field to Azerbaijan’s sovereign wealth fund (Figure 2).

**Figure 2**: Flows in kind (solid) and cash (dotted) from the ACG

The green lines show flows that are being revealed under the EITI. That is money the oil companies pay the government of Azerbaijan for taxes etc. as well as the government’s share of the profit oil the funds from the sale of which accrue to the State Oil Fund of Azerbaijan (SOFAZ). The red line stands for the associated gas SOCAR receives from the ACG field free of charge which represents a significant contribution to the company. In kind transfers of profit oil to the government of Azerbaijan (currently 80% of the ACG profit oil) are sold for the government through SOCAR Trading.

Over the project cycle of the ACG, the government of Azerbaijan would earn 195bln USD and SOCAR 4.4bln USD at 60USD/bbl (Ahmedov, 2011, p. 27). However, it is not likely that peak earnings around 20bln USD/a will last longer than until 2013. From then on, a sharp drop in production as well as earnings from the ACG is expected. The production of natural gas and gas condensate are expected to pick up starting in 2017 and could compensate for the drop in oil production.
The EITI reports pertain to those flows marked in green color (see Figure 3), thus to the government’s share of the profit oil (in kind) as well as the taxes accruing to the government from the oil companies participating in the exploitation of the ACG (IOCs as well as the NOC SOCAR). Consequently, the EITI reports reveal the following figures (see Table 1).

### Table 1: Aggregated information of Azerbaijan's EITI reports and *SOFAZ's annual income statements

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<td><strong>Income (mln. USD unless stated otherwise)</strong></td>
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<td>Crude oil (mln. barrels)</td>
<td>6.6</td>
<td>14.3</td>
<td>19.0</td>
<td>30.3</td>
<td>191.6</td>
<td>215.4</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Gas (bln. Nm³)</td>
<td>1.0</td>
<td>1.8</td>
<td>2.2</td>
<td>2.3</td>
<td>3.7</td>
<td>3.2</td>
<td></td>
<td></td>
</tr>
<tr>
<td>*Profit of transferred product from IOCs</td>
<td>966</td>
<td>1,439</td>
<td>617</td>
<td>1,029</td>
<td>14,391</td>
<td>9,591</td>
<td>15,769</td>
<td></td>
</tr>
<tr>
<td><strong>Other inflows to Government from the foreign extractive industry companies</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Transit duties</td>
<td>13</td>
<td>14</td>
<td>17</td>
<td>12</td>
<td>4</td>
<td>4</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Compensation: non-performance of contract</td>
<td>41</td>
<td>4</td>
<td>50</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Signing &amp; other bonuses</td>
<td>1</td>
<td>49</td>
<td>68</td>
<td>4</td>
<td>1</td>
<td>2</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Mining tax (Royalties) &amp; acreage fees</td>
<td>19</td>
<td>9</td>
<td>7</td>
<td>4</td>
<td>1</td>
<td>130</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Profit Tax</td>
<td>1,100</td>
<td>2,264</td>
<td>2,606</td>
<td>674</td>
<td>972</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>PSA entitlement from oil production</td>
<td>20</td>
<td>25</td>
<td>47</td>
<td>14</td>
<td>50</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>PSA entitlement from gas production</td>
<td>131</td>
<td>81</td>
<td>268</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Financial inflows from IOCs</td>
<td>73</td>
<td>18</td>
<td>68</td>
<td>1,190</td>
<td>2,364</td>
<td>2,793</td>
<td>775</td>
<td>1,426</td>
</tr>
<tr>
<td>Total profits from IOCs</td>
<td>1,038</td>
<td>1,456</td>
<td>684</td>
<td>2,218</td>
<td>4,345</td>
<td>17,183</td>
<td>10,366</td>
<td>17,196</td>
</tr>
<tr>
<td><strong>Financial inflows from local extractive industry companies</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Profit tax</td>
<td>68</td>
<td>10</td>
<td>34</td>
<td>113</td>
<td>300</td>
<td>378</td>
<td>265</td>
<td></td>
</tr>
<tr>
<td>Other taxes</td>
<td>186</td>
<td>167</td>
<td>81</td>
<td>282</td>
<td>266</td>
<td>502</td>
<td>111</td>
<td>139</td>
</tr>
<tr>
<td>Royalties / mining tax</td>
<td>399</td>
<td>194</td>
<td>168</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Price changes</td>
<td>25</td>
<td>70</td>
<td>250</td>
<td>71</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total profits from local companies</td>
<td>186</td>
<td>633</td>
<td>427</td>
<td>535</td>
<td>1,136</td>
<td>1,477</td>
<td>1,038</td>
<td>404</td>
</tr>
<tr>
<td>Total rents from oil and gas to SOFAZ</td>
<td>1,224</td>
<td>2,089</td>
<td>1,111</td>
<td>2,753</td>
<td>5,481</td>
<td>18,660</td>
<td>11,404</td>
<td>17,600</td>
</tr>
<tr>
<td><em><em>Spending</em> (mln. AZN unless stated otherwise)</em>*</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>SOFAZ payments to the government</td>
<td>731</td>
<td>871</td>
<td>233</td>
<td>981</td>
<td>1,061</td>
<td>4,292</td>
<td>5,295</td>
<td>6,373</td>
</tr>
<tr>
<td>of which transfers to the national budget</td>
<td>500</td>
<td>650</td>
<td>150</td>
<td>585</td>
<td>585</td>
<td>3,800</td>
<td>4,915</td>
<td>5,915</td>
</tr>
<tr>
<td>of which financing of national projects</td>
<td>231</td>
<td>221</td>
<td>83</td>
<td>396</td>
<td>476</td>
<td>492</td>
<td>380</td>
<td>458</td>
</tr>
<tr>
<td>SOFAZ payments to gov. (mln. USD)</td>
<td>769</td>
<td>947</td>
<td>259</td>
<td>1,102</td>
<td>1,248</td>
<td>5,171</td>
<td>6,619</td>
<td>7,966</td>
</tr>
</tbody>
</table>

According to an analysis by the Revenue Watch Institute, the Government of Azerbaijan received 78% of its total revenues in 2008 from its extractive industry. This accounted for 40% of Azerbaijan’s gross domestic product (Gillies, 2011, p. 4). The profit of the sale of profit oil and gas from the international PSAs accrues to the State Oil Fund of the Republic of Azerbaijan (SOFAZ), which does publish its revenue. In the end, from the EITI alone it is not clear how

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11 Calculation based on 1 USD = 0.8 AZN for income and real average conversion rates for spending.
much money the government earned from selling its oil and gas. Sales are handled by SOCAR Trading which is incorporated in Switzerland and not required to publish company reports.

Asadov discusses the EITI’s contribution to transparency in Azerbaijan over the years. While under Soviet practice, hardly anybody knew how much money was generated by the oil industry, now figures are available. This clearly is an improvement. Since EITI reporting began, the need to reform the State Oil Company of Azerbaijan has become evident for its vested interests as government representative and commercial company. Furthermore, it is clear now that while the EITI only covers extraction under international PSAs, SOCAR’s own production remains largely obscure. Improvements have been reached regarding the reporting of the provision of associated gas by the members of the Azerbaijan International Operating Company (AIOC), the consortium of international oil companies that produces the fields, to SOCAR. Furthermore, reporting is becoming more and more detailed with less money left in the “miscellaneous column” (Asadov, 2009, p. 98). However, the role of SCOAR as a national oil company is ambiguous with regards to direct cash flows to the government beyond taxes and should be observed more closely.

**SOCAR’s role**

This section illustrates how money that is earned by the company SOCAR finds its way into the budget of Azerbaijan, circumventing the EITI process which should give a comprehensive account of the resource revenues a state uses.

A closer look at Azerbaijan’s oil & gas sector reveals the benefits of having a NOC which is completely and immediately controlled by the government\(^{12}\). Not all producing fields in Azerbaijan are covered by the EITI and rents can be extracted at any point of the value chain. In production, contracting companies can inflate costs in the absence of competition. The absence of competition is a general problem in Azerbaijan and SOCAR does have subsidiaries that provide services to the oil and gas industry.

In 2009, ca. 80% of oil and condensate (40.2mln. t) in Azerbaijan was produced from the ACG field and 20% (10.2mln. t) were produced from other fields. 8.5mln. t produced by SOCAR in 2009 do not fall under the EITI. Of 23.7bcm natural gas produced overall, not all was available for consumption. From the ACG, 3.9bcm of associated gas were delivered to SOCAR free of charge, while 6.5bcm were re-injected (or vented/flared). Azrneft, which produced 6.9bcm associated gas in 2009, must have re-injected substantial amounts to uphold pressure in its more

\(^{12}\) The President of Azerbaijan appoints SOCAR’s president and vice presidents.
than 30 year old fields – in 2008, 54% of SOCAR's oil was produced through gas-injection (SOCAR, 2009a, p. 18). It is therefore likely, that SOCAR did not produce more than 2bcm natural gas outside of the EITI scheme (SOCAR, 2009a, p. 12). According to SOCAR, it sold 8.9bcm to the domestic market (of which 3.1bcm to Azerigas and 4.3bcm to Azerenerji), while only 0.5bcm were exported (SOCAR, 2009a, p. 19). Remember that associated gas from the ACG is transferred to SOCAR free of charge (red line in Figure 3).

From its 17 joint ventures, in but four of which SOCAR has a majority share the company had only 35.7mln AZN income (SOCAR, 2010, p. 50). Of its associates, SOCAR reported 380mln AZN profit, mainly thanks to 240.5mln AZN from its 23% share in Azerbaijan BTC Ltd. incorporated in the Cayman Islands, its 10% share in the South Caspian Pipeline Company, equally incorporated in the Caymans and its 50% share in Supra Holding, located in tax friendly Malta (SOCAR, 2010, p. 52).

As there are no financial statements of SOCAR's trading branch available, it is impossible to tell, how much money SOCAR earned selling its oil and gas internationally or to exclude that money is siphoned off somewhere. However, this is relevant, because the company’s income is used by the government for social purposes and as additional budget (Lussac, 2010).

SOCAR plays an important social role for Azerbaijan: it had 71,585 employees total in 2009 (SOCAR, 2009a, p. 34) and a reported a net operating income of 1.4bln EUR in that year (SOCAR, 2009b). This is by comparison with other international oil companies an astonishing number: Statoil, also a NOC, only had 30,300 employees but 17.5bln EUR net operating income (Statoil, 2011). In January 2008 the base salary of all SCOAR employees was raised by 20% (SOCAR, 2008, p. 42), which also points to SOCAR's public function. This is confirmed in the following citation: “About 15 thousand internally displaced peoples are cared, who resettled in the buildings and social facilities being at the balance of enterprises and organizational structures within the SOCAR and 3006 persons out of them were provided with job opportunities" (SOCAR, 2009a, p. 139). SOCAR constructed health care facilities in line with the “State Program on social-economic development of the regions of Azerbaijan Republic (2004-2008)” and the “Additional Actions Program on acceleration of social-economic development of the regions of Azerbaijan Republic” in ten districts with ongoing works in 6 other locations (SOCAR, 2009a, p. 135). Almost 3mln AZN were spent on housing projects (SOCAR, 2009a, p. 137), and 1.3mln AZN on cultural buildings and a New Year’s Eve party for 70,000 children (SOCAR, 2009a, p. 138). SOCAR contributed to the implementation of the “Actions Program on acceleration of social-economic development of settlements surrounding Baku city” approved by
Decree #1338 (27.02.2006) by improving dweller’s settlements (SOCAR, 2009a, p. 135). Overall, SOCAR spent ca. 455.8mln AZN in 2009 (516.9mln AZN in 2008) on medical services, utilities, recreational and cultural services provided to SOCAR employees, as well as on free medical services for Azeri citizens (SOCAR, 2009a, p. 88). The company is used to directly distribute benefits from resource extraction among selected groups to coopt them.

Through its acquisition of Azerigaz CJSC, SOCAR took on the responsibility for the improvement and development of the gas grid in Azerbaijan according to Presidential Decree #80 (14.04.2009). It is estimated that the company will have to spend ca. 1.1bln AZN between 2011 and 2013 to meet the policy goals. To guarantee Azerbaijan's domestic gas supply, the Ministry of Industry and Energy committed on 27.02.2003 to buy fixed quantities of gas annually from the Azerbaijan Gas Supply Company (AGSC13), which is responsible for the sale of the gas from the 1st Phase of the Shah Deniz gas field development. SOCAR is obligated to fulfill the commitment for the Ministry and paid 69.3mln AZN for gas to AGSC (SOCAR, 2010, p. 72ff.). Outstanding receivables from private and state customers are a major problem for SOCAR. In 2010, these amounted to ca. 2bln AZN14 (SOCAR, 2010, p. 39). Between January 2010 and December 2010, receivables worth 1.2bln AZN were written off as uncollectible (SOCAR, 2010, p. 45). Close to 2bln AZN defaulted in 2010, for example, because of the decision to write off the debts of mostly public electricity consumers (2010). While Azerenerji, the state utility, was directly concerned, the decision finally cost SOCAR, as it did not receive payments for the gas it had provided to Azerenerji for power generation. The debt write-off is politically relevant because most of it aids the budget of selected public companies and ministries.

They receive funds not foreseen in the budget and they receive them as the result of an ad-hoc decision. Writing off debt worth a couple hundred million AZN per agency sustains bad financial management in the benefited bodies. It also strengthens political control over those organizations.

A third way SOCAR fulfills public functions is through direct payments. Direct payments to the government are referred to as “Withdrawals by the Government” by SOCAR and defined as follows: “Withdrawals by the Government represent ad-hoc cash contributions which the Group may be required to make to the state budget, various government agencies and projects

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13 Owned by Statoil (operator – 20.4%), BP (20.4%), the Ministry of Industry and Energy of the Azerbaijan Republic (20%), LUKOIL (8%), NICO (8%), SOCAR (8%), Total (8%) and TPAO (7.2%)

14 Down from 3.3bln AZN in 2009 after receivables had been written off.
administered by the government based on the particular decisions of the Government. Such withdrawals are recorded as a reduction of equity.” (SOCAR, 2009a, p. 56) Total Withdrawals by the Government: 286mln AZN (2009) and 475.7mln AZN (2008) (SOCAR, 2009a, p. 42). As cash contributions or finance construction and repair works for the state budget, various government agencies and projects administered by the government were given 242.6mln AZN in 2009\textsuperscript{15} total and 420.4mln AZN in 2008\textsuperscript{16} (SOCAR, 2009a, p. 43).

The company’s contributions to the state range between 1bln AZN and 3bln AZN per year. This money is not reported under the EITI, but thanks to SOCAR’s improved accounting and reporting, it can be assessed. Sound financial management would require those transfers of resource revenue to be channeled through SOFAZ, of which one core function is to control the amount of oil money flowing into the economy, and to orderly record it in the state budget.

The EITI’s impact

Corruption

This art of the paper aims to answer, if the EITI curbs corruption in compliant countries and thus aids the accountability of government towards its citizens.

Although the above mentioned numbers are certainly interesting, it is not immediately clear how they help to fight corruption. Corruption is so rampant in Azerbaijan still that legal transactions between public and private actors are the exception rather than the rule (Weißenberg, 2003, p. 1; Meissner, 2010; Turan News Agency, 2011; U.S. Department of State, 2011). This casts serious doubt on the initiative as well as on the political commitment of political elites against corruption. When the protests in Northern Africa started, the Interior Minister of Azerbaijan asked the traffic police not to bother the population too much with corruption (Thompson, 2011). Apparently, the successful implementation of the EITI and improvements do not actually address corruption.

The regularly conducted Business Environment and Enterprise Performance Survey shows that in Azerbaijan, often supplementary payments are expected for standard public tasks necessary for business operation (EBRD and The World Bank, 2009). As laws are published but legal

\textsuperscript{15} of which direct contributions 143.7mln AZN and financing 142.3mln AZN SOCAR, Annual Report, Baku, 2009a, p. 87.

\textsuperscript{16} of which direct contributions 313.9mln AZN and financing 161.8mln AZN Ibid., p. 87.
ordinances are not, it is not clear whether the regulations entrepreneurs face exist in the first place but are not well communicated, not well understood, or simply assumed to be symbolic. This distance from the law is easily explainable by how little trust people have in the judiciary system (EBRD and The World Bank, 2009). All in all there is a great divide between the public and the state, or rather between formal rules and what actually happens in Azerbaijan. In each case, individuals weigh if it is cheaper to follow a rule or to bribe - with few inhibitions and no effect of the EITI.

While it can be said that the greatest part of oil, gas and money accruing to the government in Azerbaijan is publically known, the actual wealth or in kind transfers and the cash payments the government receives from SOCAR in excess of regular taxes etc. remain shady. Furthermore, the EITI does not provide any information on how the money is spent. Thus, it is not at all clear, how, for example, the 8 billion dollars that were transferred into the budget from SOFAZ in 2010 were utilized.

**Stability**

This part of the paper answers the question, if and if so, how the EITI, in spite of its limited contribution towards transparency and the improvement of financial management, enhances the stability in a country.

Corruption and nepotism were identified as important causes of the poor living conditions that people protested against in energy exporting countries of the Middle East. But, according to Transparency International’s Corruption Perception Index - which in this case unlike oftentimes is actually the perfect measure - the problem is perceived to be more severe in Kazakhstan (105th), Azerbaijan (134th), Russia (154th), Turkmenistan and Uzbekistan (both 172th) than it ever was in Egypt (98th) or Tunisia (59th) (Transparency International, 2010). Poor living conditions cannot by themselves be the reason for protest either, because poverty is on average much higher for example in South Asia than in Northern Africa and the Middle East (Yang and al., 2009, p. 19)17. Unemployment among female youth in 2007 reached almost 70% in Armenia and over 50% in Bosnia and Herzegovina, Macedonia and South Africa. Albeit closely followed by Syria and Egypt with 49% and 48% respectively. Regarding unemployment among male youth in 2007, Poverty in Azerbaijan was also widespread before the big money came in HABIBOV Nazim N. and FAN Lida, «Social protection and poverty in Azerbaijan, a low-income country in transition: Implications of a household survey», *International Social Security Review*, n° 60/4, 2007, p. 47–68. and still is an important issue, especially among the huge numbers of internally displaced persons.
again Armenia (47%) and even Georgia (28%) are more affected than Egypt (17%) or Syria (13%) (Cornu and Vittorelli, 2011). The countries that have experienced serious political unrest have been independent energy exporters for many decades. This is a fundamental difference between them and Azerbaijan, as the government of Azerbaijan has not been able to use the resource revenues independently until the second oil boom which is unfolding right now. It could thus not be held responsible for the level of development that they did or did not achieve with those funds. Therefore, judgments on the way the resource wealth is handled cannot yet draw on experience.

Notwithstanding the situation in Azerbaijan, the United Nations General Assembly, awarded the EITI implementation by SOFAZ with the 2007 UN Public Service Award in the category of “Improving transparency, accountability and responsiveness in the Public Service” (United Nations Public Administration Network, 2007). And in 2009 Azerbaijan was awarded the "2009 EITI Award" for its commitment to the EITI principles its implementation (SOFAZ, 2009). The EITI affirms that a country manages its revenues well and provides a label of international approval of the financial management at work.

For Azerbaijan, this international recognition can be an important asset. First of all, the government can justify its actions towards their people although many of them benefit less from the riches than they could. Secondly, if the government’s commitment to improve the financial management should not be sincere, the EITI label can indicate that pro forma action is enough. Even SOFAZ’s way of spending is subject to critique (International Crisis Group, 2010) and taking part in some sort of EITI+ initiative, which would include transparency of spending, is not envisaged. Thirdly, the efficient management of money coming into the country is a means to guarantee control over its distribution (Cornell, 2010, p. 177).

Conclusion

The EITI is a global initiative which aims to increase public information regarding the amount of money a state makes from the exploitation of its minerals, metals and hydrocarbons. To promote sustainability and good governance, it strives to help the citizens of a resource-rich state to hold their government accountable. The EITI reports as such seem rather informative than enabling.

Joining efforts for sustainable development and subscribing to initiatives such as the EITI can have a twofold rationale: 1. The government of Azerbaijan is supporting the EITI, because it is regarded as the right thing to do by the international public (Sandholtz and Gray, 2003; Hawkins, 2004), and because the EITI enhances domestic legitimacy. 2. Improving governance - for
example as it pertains to resource extraction - to maintain centralized corruptive systems and control. Thus by disclosing how much taxes accrue form oil companies and by collecting the revenues from the sale of oil and gas in SOFAZ and SOCAR, the revenue streams are centralized under the direct control of the President of Azerbaijan who appoints the directors of SOFAZ, the presidents of SOCAR and the tax minister (and ultimately decides upon the national budget).

The comprehensive transparency – good governance – stability nexus does make sense in a long-term perspective. Legitimate governance that is supported by people who largely refer to formal rules to guide their actions is the most efficient way of steering a society. It is stable in the way a ship is stable when it moves around on the oceans: systems which are well governed in this sense are adaptive to changes because of the impersonal and general aspects of their organization. At the same time, centralized corruption is an effective means of control. It is, however, relatively costly, as loyalty is commercialized. Because of the direct link between political position and wealth, corruptive systems are geared towards rigidity with respect to individual positions and processes. Stability, then, is not the ability to successfully adapt to change while preserving a system’s fundamental characteristics, but the strength to withstand changes, because in the absence of common values and collective goals, every change threatens the integrity of the system. Governance in the latter case is a question of implementation, rather than management. Measures to improve governance then might improve the state machine, thus the ship, but the immanent goal would be to keep the ship in place instead of steering through rough seas.

Transparency threatens the “stability” of a corruptive system, because it destroys the means of control (mutual dependence on secrecy), unless it can be used to improve implementation. Income transparency without transparency on spending seems to do exactly that. A question to be answered in the future then is which and how much involvement of international actors is needed to facilitate such a fundamental transformation smoothly.

Although the validation process for the EITI includes various stakeholders, it is not public per se. NGOs and individuals can join the EITI and then attend the meetings or send representatives to attend the meetings. The minutes of the meetings are not available to outsiders. Indeed, the numbers initially provided both by the government and the companies are not published. Yet, even high discrepancies are often simply explained by “accounting mistake”. While the EITI product - the final report - does not empower civil society to hold its government accountable, the validation process could. It trains the participating civil society representatives, because they are confronted with numbers signifying tax laws, company budgeting and energy resources. They learn “exactly how the financial organization behind the extractive sector works, what kind of
payment types there are, who the relevant government bodies receiving the payments are and so on” (Ölcer, 2009, p. 27). Thus, the EITI process and the related documentation build capacity in the civil society. As of June 2009, 92 NGOs and 13 individuals had signed the EITI Memorandum of Understanding in Azerbaijan and thus became part of the EITI committee (Committee on the Extractive Industries Transparency Initiative, 2003). Since the reports are publicly available, it seems that the validation process itself attracts great interest.

The capacity building the EITI offers to participating representatives of civil society and its wider effect on the national and international extractive companies are valuable. Still, in and of itself, from the perspective of sustainable development, the EITI is in danger of simply becoming a numbers game, which is probably one very important reason for the EITI’s wide acceptance by governments all over the world.
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