Chapter III

NATURAL RESOURCES AND NATION-BUILDING PROCESS
The economic history of the past four decades shows that the future focus will be on energy, oil and development. Never before in the history of mankind have these three sources of wealth, power and conflict been as interrelated as they are today. Nor have they ever before commanded the attention of so many of the world’s intellectual, scientific and financial experts as they do at present. Initially, it would seem that the most important factor responsible for the evaluation of energy as a source of deliberate economic and social development was man’s growing awareness of his material and social needs, the revolution of rising expectations. As needs and desires multiplied in quantity and in quality, overall economic and social development became a necessity for their satisfaction, individually and collectively. (Agnew, 1998, pp. 5-11)

For the oil exporting countries the exploitation of their most valuable natural resource by foreign oil companies had only one role to play: it was regarded by the governments of these countries as a source of fixed income per barrel of oil exported. Domestic oil consumption was too small to be noticed and the industrialization of the oil sector in the producing countries was thought to be neither possible nor feasible.

Under these circumstances, oil became more than just another source of energy within the global energy transition. The possession and management of the international oil industry became a great source of economic and political power. Whether for war or for peace, economic development or income distribution, domestic use or international trade, the role of oil resources became an essential part of the national policies of the industrially advanced countries. The role of oil reserves for the exporting countries has been described as a ‘development bridge’ over which these countries may pass to the
stage of economic development with or without oil exports. It is natural that the achievement of this goal requires proper planning, efficient implementation and international cooperation.

ENERGY SECURITY AND ECONOMIC DEVELOPMENT

The availability and security of adequate energy supplies are prerequisites for the initiation and sustenance of economic and social development. The availability and cost of oil and gas supplies will continue to determine the course of energy economics in the world at large and in individual countries for the foreseeable future. However, the achievement of adequate economic and social development requires more than secure energy supplies. Since economic development may be broadly defined as a continuous process of increasing the production, distribution and consumption of goods and services through increased investment and productivity, it is clear that an adequate energy supply is only one of the essential ingredients. Other equally essential ingredients are capital investments, skilled human resources, large enough markets and, above all, efficient management. (Menon, 1998, p. 11)

With the present geopolitical structure of the world, the developing countries are too weak to cope with the enormous task of economic development and the challenge of common security for their respective regions. Indeed, there are few such countries with large domestic markets and diversified natural resources capable to support their socio-economic development without significant regional economic integration. For most of the other developing countries, however, the option of national development without regional co-operation can only lead to more dependence on and increased integration with the economics of the developed countries. In fact, this is the present situation for the majority of the developing countries. The
smaller the country and the more dependent it is on the export of one or a few commodities or services, the greater is its dependence on the powerful economics of the developed countries. (Attiga, 1988, pp. 1-5)

With global oil demand expected to rise at the rate of one million barrels per day (bpd) per year throughout the rest of the decade, the Caspian has seized the attention of the industrialized countries and offered the potential for huge and currency revenues for the littoral states. The largely untapped energy reserves of the Caspian Sea were opened to significant international investment following the break-up of the Soviet Union. Experts now estimate the Caspian to contain 15.6 billion barrels of prove recoverable oil reserves and a further 163 billion barrels of possible reserves. These vast oil deposits - twice as large as believed previously - represent the biggest oil find since the opening of the North Sea in the 1970s. (Gidadhubli, 30 January 1999, p. 1)

The presence of oil in the Caspian region can be traced back to the 13th century. Throughout the 20th century, Caspian oil has played a key role in world politics. In the late 1800s, great oil barons competed among themselves to gain control over the region. This region played an important role during both the world wars. Though oil deposits are located throughout Transcaucasia, Caspian area is particularly rich in oil deposits. Recent geophysical estimates indicate that the area holds far more than the Soviet estimate of 10 billion barrels. Additionally, the hydrocarbon resources are very deep and strong currents make geophysical work difficult.

**History of Oil Exploration in Azerbaijan**

Azerbaijan has been linked with oil for centuries, even for millennia. Medieval travelers to the region remarked on its abundant supply of oil, noting that this resource was an integral part of daily life there. By the 19th century,
Azerbaijan was by far the frontrunner in the world's oil and gas industry. In 1846 AD, more than a decade before the Americans made their famous discovery of oil in Pennsylvania-Azerbaijan drilled its first oil well in Bibi-Heybat. By the beginning of the 20th century, Azerbaijan was producing more than half of the world's supply of oil.

Arabian traveller Baladzori alias Al Belazuri Ahmad wrote in 9th century that political and economic life on Absheron had long been connected with oil. In the next century (10th century), Arab historian Masudi-Abdul-Hussein identified two main sources of black oil and white oil (kerosene) on Absheron. Another Arab historian Istahri-Abu Iskhak described how the people of Baku used soil soaked in oil as fuel. After visiting Absheron in 13th century, a prominent Arab historian Muhammad Bekran wrote about the shaft extraction of oil in Balakhani which is a suburb of Baku now. (Mir-Babayev, Summer 2002, Online: Web)

In his *The Travels of Marco Polo*, the world famous Venetian traveller Marco Polo (1254 AD-1324 AD) indicated that oil from Baku was being exported to Near Eastern countries. He also described the use of oil as an unguent used in therapeutic healing. In 1594 AD, an inscription inside a well 35m deep in Balakhani indicated the date of construction and the name of the builder - Allah Yar Mammad Nuroghlu. In 1636 AD, German diplomat and traveler, Adam Oleari (1603-1671) described Baku's 30 oil wells and said that oil gushed out of them with a mighty force. He identified both brown and white oil and wrote that there was a greater quantity of the brown. In 1647 AD, Turkish traveller Evliya Chelebi travelled to Baku to study and describe its oil fields. He noted that from olden times the political and economic life in this region had been closely connected with oil. In 1683 AD, naturalist and traveller Engelbert Kaempfer (1651 AD-1716 AD), Secretary of the Embassy of
Sweden to Persia, visited Baku and provided a detailed description of Absheron's oil resources. He wrote that oil was transported via wineskins on four-wheeled carts to Shamakhi and Baku. From Shamakhi, it was taken across the country on camels. From Baku, it was taken by sea to the Uzbek and Cherkassy regions and to Dagestan. (Mir-Babayev, Summer 2002, Online: Web)

In 1723 AD, Tsar Peter the Great (1672-1725) issued laws related to oil extraction. In his letter to General Mikhail Matyushkin, who occupied Baku, the Czar demanded huge amount of white oil or as much as possible and the search for an oil consultant specialist. In 1883 AD, English traveller and writer Charles Marvin visited Baku's oil fields. Between 1883 and 1886, he wrote books like *The Russians at Marv and Herat, The Region of Eternal Fire, Petroleum Region of the Caspian, Baku is the Petroleum of Europe* and *Russia's Power of Attacking India*, which were dedicated to the development of oil business in Absheron and the Transcaucasus. (Mir-Babayev, Summer 2002, Online: Web)

After the construction of the Caucasus railroad, a 514-verst¹ (54 kms) long railway system connecting Baku and Batum, the Rothschild Brothers established the Caspian and Black Sea Oil Industry and Trade Society. Minister of State Property, Michael Ostrovsky arrived in Baku accompanied by his brother, the famous playwright Alexander Ostrovsky (1818-1883), to discuss oil problems. In 1884 AD, in Baku a special organization of entrepreneurs called the Council of Baku Oil Industrialists was established under the directorship of Ludvig Nobel until 1888. The world's largest kerosene pipeline (829 verst, or 885 kms long) was built between Baku and Batum between 1897 to 1907. The pipeline belonged to the Transcaucasus Railroad. The Rothschild

¹ A verst is a Russian unit of distance that is equal to 1.067km.
brothers founded the Mazut Transportation Society in 1898 AD. By 1912, it already had 13 large tankers in the Caspian Sea, plus other auxiliary ships. In 10 January 1899, a new bi-weekly called *The Oil Business* started publication. Two new oil and trade societies were founded: the Souchastniki (Collaborators) and the Absheron Oil Society. The Nobel Brothers Company, the largest oil company in Baku, extracted 93.2 million poods [1.5 billion kg] of oil, amounting to 17.7 per cent of Russia's total production and 8.6 per cent of the world's total oil extraction. Between 1899 AD to 1901 AD, Baku's oil industry ranked first in the world in terms of total oil extraction, with a total of 11.5 million tons a year. At the time, the US was only producing 9.1 million tons. (Mir-Babayev, Summer 2002, Online: Web)

The oil industry of Azerbaijan has been developed immensely with the help of professionals from Russia, Germany and other European nations. Special mentions may be made regarding the contribution offered German and Russian scientists Carl Engler and Dmitry Mendeleyev. The presence of oil in the Caspian region is recorded as far back in the 13th century. Throughout the 20th century, Caspian oil has played a key role in world politics. In the late 1800s, great oil barons competed among themselves to gain control over the region. In carried strategic weight in both the World Wars. Though oil deposits are located throughout Transcaucasia, Caspian area is particularly rich in oil deposits. Recent geophysical estimates indicate that the area holds far more than the Soviet estimate of 10 billion barrels. Additionally, the hydrocarbon resources are very deep and strong currents make geophysical work difficult.

At least 80 oil and gas related joint ventures are operating in the region currently.

The five largest current development projects are:
i) The Kazakhstan-Chevron joint-venture between the US company Chevron and the Kazakhstani Tenghiz oil field, known as Tengizchevroil;

ii) The Azerbaijani offshore oil project consortium;

iii) The Azerbaijani-Karabakh field in the Caspian;

iv) Kazakhstan’s Karachangank oil and gas field; and

v) On set of projects in Kazakhstan’s offshore area.

In 1991, a number of foreign companies, including Amoco, British Petroleum, McDermitt, Penzoil, Ramoco, Unocal, TPAO and Statoil, began negotiating with Azerbaijan to develop the Azeri, Chirag and Gunisheli fields in the Azeri sector of the Caspian Sea. After protracted and difficult talks, the companies were prepared to sign an agreement with Azerbaijan’s pro-Turkish, anti-Russian President Elchibey in June 1993, whereby Azerbaijan’s State Oil Company (SOCAR)² retained a 30 per cent share of the consortium project. When Elchibey’s government was subsequently overthrown, the companies found themselves back at the negotiating table with a new government headed by former Communist party boss Heyder Aliyev. (Carver and Englefield, June 1994, pp.119-121)

The benefits of developing and exploiting the Caspian region’s oil resources are clear. First, the margin between world oil production capacity and world demand is projected to narrow in the next decade, leading to greater dependence on the Persian Gulf. Central Asian and Caspian oil could offer an

² SOCAR is the Decree of the President of Azerbaijan Republic regarding the improvement of the structure of the State Oil Company of Azerbaijan Republic After Azerbaijan Republic obtained its state independency, carrying out the reforms in the economy and state board has become one of the significant obligations. For details see, http://www.socar.gov.az/decree-en.html
important alternative. In consequence as powerful geo-strategic key, oil offer the regions’ states their best opportunity for true independence in seventy years.

DEVELOPMENT OF CASPIAN OIL FIELD

In October 1993, the companies signed a new development protocol, which excluded the developed part of the Gunisheli field. Fields remaining in the reformed projects have combined recoverable reserves estimated at 3.3-3.7 billion barrels of oil lying some 193 kms offshore. After several months of complex bargaining, the final project deal worth an estimated $8 billion in capital investments was signed on 20 September 1994. The signing ceremony evoked a mixed reaction from Russia, with Stanislav Pugach, then Chief of the Russian Ministry of Fuels and Energy, attending the ceremony while the Ministry of Foreign Affairs spokesperson publicly condemned the deal as illegitimate, since the legal status of the Caspian Sea has not yet been determined. At one point, the then Russian Foreign Minister, Kozyrev, allegedly proposed economic blockades against Azerbaijan to punish Baku for signing the deal. The companies in the consortium are concerned that Russia could easily apply even more pressure through its control over the Volga river, the only way to bring the heavy equipment necessary for the project into the Caspian. After the signing, the project required ratification by the Azerbaijani Parliament. On 12 December 1994, the Azerbaijani Parliament passed the proper legislation and the deal was finalised. Shares in the consortium, according to the agreement at the time of the signing were as follows: (Shams-Ud-Din, 2000, p.14)

1. Socar (Azerbaijan) 20 per cent
2. British Petroleum (UK) 17.3 per cent
3. Amoco (US) 17.01 per cent
4. Lukoil (Russia) 10 per cent
5. Pennzoil (US) 9.82 per cent
6. Unocal (US) 9.25 per cent
7. Statoil (Norway) 8.56 per cent
8. Mc Dermott (US) 2.45 per cent
9. Ramco (Scotland) 2.08 per cent
10. Delta-Nimir (Saudi Arabia) 1.68 per cent
11. TPAO (Turkey) 1.75 per cent

In December 1994, the consortium established the Azerbaijan International Oil Company (AIOC) to oversee the project’s day-to-day operation. It will use $8 billion in capital investments to produce approximately 3.7 billion barrels of oil over then next 30 years. About 70 per cent of the profits from the deals will go to Azerbaijan, which will receive about $300m in bonus payments. One of the greatest challenges for the consortium will be finding a way to export the oil, now that laborious negotiating phase has been concluded. At this point, none of the options for long-term export appear very stable or attractive. They include many pipelines that would pass through Iran, through politically unstable Georgia or through Russia, giving it a monopoly over most oil exports from the region. The potential problems include: (Shams-Ud-Din, 2000, pp.13-17)

- the spread of the Nagorno-Karabakh war;
- a sharp deterioration in Russian-Azerbaijani relations;
- internal instability in Azerbaijan;
- the Azerbaijan government’s failure to find a stable export route-
Getting the Caspian oil out of the region and into the international market is a key issue that will ultimately deeply affect the political and economic fate of the countries concerned. This is the area in which domestic complication in each of these countries combine both with the strategic competition among the region’s powerful neighbors and with over-arching technical and infrastructure problems, to produce a seemingly intractable puzzle. The substantial profits and powers at stake, however, continue to attract a spectrum of entrepreneurs and political players.

Table 1

<table>
<thead>
<tr>
<th>Azerbaijan’s Economy and Energy</th>
<th>In million nominal US dollars unless otherwise indicated</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2003</td>
</tr>
<tr>
<td>Oil production*</td>
<td>320</td>
</tr>
<tr>
<td>Oil exports*</td>
<td>215</td>
</tr>
<tr>
<td>FDI**</td>
<td>3,285</td>
</tr>
<tr>
<td>Oil sector FDI**</td>
<td>3,246</td>
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<tr>
<td>Oil sector revenue</td>
<td>886</td>
</tr>
<tr>
<td>As share of total revenue (%)</td>
<td>42</td>
</tr>
<tr>
<td>As share of total GDP (%)</td>
<td>-</td>
</tr>
<tr>
<td>Oil Fund Assets</td>
<td>816</td>
</tr>
</tbody>
</table>

* Thousand barrels per day  **Foreign Direct Investment

Source: US Energy Information Administration, Short Term Energy Outlook Other Indicators from IMF, Article IV Consultation-Staff Report, No. 07/191, June 2007.

GEOPOLITICS OF THE CASPIAN SEA

The term ‘geopolitics’ dates from the late nineteenth century but has become a widely used signifier for the spatiality of world politics in the late twentieth century. John Agnew along with Stuart Corbridge has given the most comprehensive historical and materialist theory of modern geopolitics in recent years. Blending the Marxian political economy of Antonio Gramsci and the
writings of the French philosopher, Henri Lefebvre, Agnew provides a general theory of geopolitics that treats it both as practices and ideas, as a materialist world order and as a discursive set of understandings and rules. The result is what both Agnew and Corbridge once termed ‘geopolitical economy’, a hybrid of geopolitics and political economy. (Brown, 1996, pp. 9-13)

Building on these distinctions, Agnew and Corbridge make a crucial distinction between geopolitical order and geopolitical discourse, the first a worldwide political economy of spatial practices, while the second is a congealed hegemonic organization of representations of space. Their notion of hegemony, derived from Gramsci and supplemented by the work of Robert Cox (1987), places great emphasis on the ensemble of rules and regulations enmeshing and conditioning actors in world politics.

The current post-Cold War epoch is described as a hegemony without a dominant state hegemony, a geopolitical order dominated by powerful countries like Germany, Japan and the United States, integrated by worldwide markets and regulated by transnational institutions and organizations like the European Union, the World Trade Organisation, the International Monetary Fund, and the World Bank. (Brown, 1996, pp. 9-13) The hegemonic ideology of this epoch is transnational liberalism, the belief that universal progress lies in the expansion and extension of capitalist markets across the globe. (Buzan, 1991, pp. 2-6)

Geopolitics is a complex cultural matrix, where identities are formulated, represented and changed in contemporary geo-political discourses. Geopolitics is also about the crucially important power to define danger, and about the ability to describe the world in ways that specify appropriate political behaviors in particular contexts to provide ‘security’ against those dangers. The
power to construct a popular understanding of the context is a crucial
discursive task of geopolitics.

In the last decade, many of the dangers are understood as ‘global’ and
the response in policy-making circles has often been to discuss matters of
newly defined threats in terms of ‘global security.’ The phenomena of
international security, diplomacy and the ‘high’ politics of international
relations between the great powers have become very obviously conflated with
concerns about population culture and cultural identity in the discourses of
gepolitics. Samuel Huntington’s (1993) thesis on the likely future of global
politics starts with the assumption that multiply cultures exist in this world that
often collide in violent clashes. Conflict here is understood as the clash of
‘civilization’- the eternal lot of humanity according to the ‘tragic’ school of
realist readings of human history. Primordial identities are posited as the
premise for politics and the structural givens for the possibilities of thinking
seriously about security. While managing the area of geo-political identity for
Azerbaijan in post-Soviet phase one has to look at the above mentioned
theories.

The Caspian Sea is the world’s largest inland body of water, covering
370,000 sq kms - an area roughly the size of Japan. Geographically, the basin is
typically divided into the North, Middle, and South Caspian. The northern
portion of the sea has low shorelines and is very shallow in general, being less
than eight meters deep. The North Caspian covers 61,408 square kilometers in
area. The Middle Caspian, on the other hand, is 85,200 square kilometers in
area with a depth of 95-130 meters at its shallowest. The western shore of the
Middle Caspian runs into the foothills of the Great Caucasus Mountains after
hitting a narrow marine plain. The South Caspian, a depression covering
92,112 square kms, contains the Caspian’s greatest depths as well as its largest
and most productive oil and natural gas fields. The most promising oil-producing area in the South Caspian is along a narrow structural zone extending across the Caspian from Azerbaijan’s Apsheron Peninsula to western Turkmenistan’s Peri-Balkhan region. Although the shallower waters of the south-western side are more extensively explored than those of the eastern side, the entire area has much potential for further oil field discoveries.

While the geography of the Caspian Sea has remained constant for millennia, the region’s geopolitics - that is, the interplay between geography and politics in the Caspian Basin - have changed significantly in the past five years. Whereas during the Soviet period the Sea was bordered by the U.S.S.R. and Iran, the post-Soviet Caspian is surrounded by five countries - Russia, Iran, and the newly independent republics of Azerbaijan, Kazakhstan, and Turkmenistan, those are faced with the immense challenges of economic and foreign policies and promote internal stability. However, the Caspian Basin’s oil wealth and strategic location at the cross-roads of Europe, Asia, and the Middle East have made the region of great interest to Russia, Iran and Turkey. The factors essential for the region’s development, exploitation and export include (a) the political interests and policies of external parties (Russian, Turkey, Iran, China, Pakistan and the US); (b) the Caspian Sea dispute (intra-regional competition); (c) the internal political problems of the region’s states; (d) commercial and technical impediments in implementing oil projects. (Kaser, 1997, p. 5)

The Caspian littoral countries have been vulnerable to the interventions of a variety of interested parties from outside the region. Russia, Turkey, the UK and Iran have, at different times, controlled substantial areas, seeking to exploit the natural endowments, and the Caspian Basin countries suffered eventual submission to the imperial powers.
In the Soviet period, transporting oil via the Black Sea was one of the routes used by the Soviet Union. With the disintegration of the Soviet Union the newly emerged states of Azerbaijan, Kazakhstan and Turkmenistan had no direct access to the open sea. These countries realized that their vast resources could bring prosperity to their people as well as help them in achieving true independence. In order to exploit these resources Azerbaijan, Kazakhstan and Turkmenistan needed investment, technological know-how and transportation to the consuming areas. Russia did not have the necessary finances to develop these resources. Hence Azerbaijan, Kazakhstan and Turkmenistan turned to the developed countries for assistance. Besides, they did not want Russia to monopolise their energy policy.

One of the biggest hurdles facing the littoral countries is the legal status of the Caspian Sea, which is still undetermined. Prior to the disintegration of the Soviet Union in 1991, the treaties of 1921 and 1940 signed between the Soviet Union and Iran provided the legal framework within which the two littoral countries operated. Now there are five littoral countries and a new legal framework needs to be negotiated. On the question of legal basis there are diverse views reflecting each country's national interest. Initially Russia staunchly upheld the view that the Caspian Sea is a closed lake and not an open sea. Therefore, the UN Convention on the Law of the Sea 1982\(^3\) did not apply to the Caspian Sea. In early 1997, there was a shift in Russian position. Perhaps

\(^3\) The United Nations Convention on the Law of the Sea, adopted in 1982, identifies navigational rights, territorial sea limits, the legal status of resources on the seabed beyond the limits of national jurisdiction, the conservation and management of living marine resources and other important features. However, the Caspian Sea is beyond the jurisdiction of the Convention, and the norms of the international law of the sea do not apply to it. The Caspian Sea needs specific legal regulation, and this is because of its uniqueness: it is neither a sea nor a lake. Online: Web, http://www.un.org/Pubs/chronicle/2004/webArticles/081304_Caspian_Sea.asp accessed on 15 February 2008.
the confirmation of oil deposits in the sector by recent geological survey may have compelled Russia to reconsider its stand.

**Azerbaijan's Stand on Caspian Sea Issue**

Azerbaijan argues that the Caspian is a sea, and thus should be divided into national sectors within which individual countries have exclusive sovereignty. Azerbaijan has gone as far as to incorporate its claim into its recently approved constitution. Under Article 2 of the Economic Independence Law and Article 10 of the Property Law of the Constitution, “Land and its mineral resources; internal and territorial waters; the continental shelf; flora; and the air basin within the limits of the territory of Azerbaijan are the Republic’s exclusive property” Kazakhstan has expressed support for Azerbaijan’s argument, but Iran and, to a lesser extent, Turkmenistan have supported the Russian position. For Azerbaijan, the status dispute is a question of upholding and strengthening its sovereignty and independence after centuries of foreign domination.

Azerbaijan has claimed that the 1982 United Nations Convention on the Law of the Sea should be applied to the Caspian. Given the Law of the Sea provisions, a compelling case can be made for the Azeri argument that the Caspian falls under the jurisdiction of the Law of the Sea and can be divided accordingly. Some relevant provisions of the Convention are:

- State are entitled to claim up to 12 nautical miles (nm) of sovereign territorial sea, between 200 and 350 nm of continental shelf depending on the configuration of the continental margin, and a 200 nm Exclusive Economic Zone (EEZ).  

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• Where claims to continental shelf and EEZ overlap (as in the Caspian), it requires that: “delimitation of the continental shelf shall be effected by agreement on the basis of international law... in order to achieve an equitable solution” (emphasis added).

• Part IX of the Convention deals with “enclosed or semi-enclosed seas”. (Therefore, being landlocked does not disqualify the Caspian from being a sea.)

• Article 122 further defines an enclosed (or semi-enclosed) sea as: “A gulf, basin or sea surrounded by two or more states and connected to another sea or the ocean by a narrow outlet or consisting entirely or primarily of the territorial seas and exclusive economic zones of two or more coastal states” According to Clive Schofield and Martin Pratt, “while the Caspian does not meet the first criterion, it is difficult to see why it cannot qualify under the second”. (Smith, Fall 1996, p. 160)

AZERBAIJAN'S NATURAL RESOURCES

Oil and gas constitute the basis of the country’s economy. According to the BP-Amoco (UK) annual guide to oil and gas statistics, Azerbaijan has proven oil reserves of 7 million barrels, equal to 0.7 per cent of world reserves and the country is a growing net oil exporter. The state Oil Company of Azerbaijan (SOCAR) is more optimistic and puts proven reserves at 17.5 billion barrels, which probably reflects the Soviet-era practice of including reserves that are either not viable or not fully proven into the total. Azerbaijan’s oil reserves are small in comparison with the Middle East where proven

“The Exclusive Economic Zone is an area beyond and adjacent to the territorial sea, subject to the specific legal regime established in this Part, under which the rights and jurisdiction of the coastal State and the rights and freedoms of other States are governed by the relevant provisions of this Convention.” For details see, www.un.org

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reserves are put at 674 billion barrels or 64 per cent of world reserves. To discover and develop new offshore oil deposits, Azerbaijan needs billions of dollars of investment in exploration, production and in downstream activities such as refining and pipeline construction. Offshore production costs are high, although SOCAR’s inefficiency makes its onshore production costs higher.

The development of Azerbaijan’s oil fields started in 1994, with the signing of the "Contract of the Century" with major Western oil companies. Today, Azerbaijan is experiencing an investment boom in the petroleum sector and the construction and service sectors. While the related balance of payments inflows currently appear quite beneficial to the country’s economy, they could turn into a curse commonly known as the “Dutch Disease.” Why, one might ask, should a country suffer from the exploitation of its natural wealth? The following problems may be relevant to the case of Azerbaijan. (Rosenberg and Saavalainen, September 1998, Online: Web)

The present scheme of allocating oil revenues through a special oil account at the central bank avoids overspending and ratchet effects. Oil revenues are within a clear accounting framework, and their distribution is therefore less prone to distortion. Surplus funds held by the central bank are part of Azerbaijan’s official international reserves and are saved abroad. However, this scheme has drawbacks: profit sharing between the central bank and the government becomes difficult, and genuine central banking functions become blurred. Therefore, it can be considered only an intermediate solution. (Rosenberg and Saavalainen, September 1998, Online: Web)

Another option would be to transfer oil revenues to an oil trust fund managed outside the budget and supervised jointly by the monetary and fiscal authorities. This fund’s proceeds could be used for public investment projects
or a funded pension scheme, or (preferably) held outside Azerbaijan (following the Kuwait Investment Office model).

To the extent that additional oil revenues would accrue to the budget, the question arises as to how they should be used. In principle, the choice would be between reducing taxation or increasing public consumption or investment. For Azerbaijan, the latter seems most sensible, since its physical infrastructure is seriously deficient. Such investments would also support the goal of mitigating real exchange rate appreciation, because expenditures on physical capital formation tend to be more import-intensive than expenditures on consumption. (Rosenberg and Saavalainen, September 1998, Online: Web)

**Exploration and Export of Azerbaijani Oil**

There has been intensive oil extraction in Azerbaijan since the second half of the 19th century. By 1900, Baku was producing 50 per cent of the world's oil supplies. Oil production peaked in 1943 at 460,000 barrels/day. Production gradually declined as the Soviet Union turned the focus of its exploration in Siberia, and equipment and facilities in Azerbaijan deteriorated. Crude production gradually fell to 234,000 b/d by 1991. Production in existing fields, particularly the old onshore fields owned by SOCAR, is declining. In 1998 SOCAR produced 182,000 b/d, a 27 per cent decline from 1990. Onshore production in 1998 was just 34,000 b/d, down by 35 per cent.

In November 1997, the Azerbaijan International Operating Company (AIOC) began production. AIOC is a British-Armenian-Norwegian-led oil consortium which signed a contract in 1994. Offshore production by AIOC reached 48,000 b/d in 1998 and climbed rapidly to 89,000 b/d in the first half of 1998 and 110,000 b/d in the first six months of the following year. Since early 1999, AIOC production has been exported via a pipeline through Georgia
to the port of Supsa. Pipeline capacity in 1999 was some 110,000 b/d but in coming years this could be doubled with additional upgrading work. ("Supsa Terminal and Pipeline, Georgia/Azerbaijan", Online: Web)

Baku-Supsa was the second export pipeline to be opened. The first, running from Baku to Russia’s Black Sea terminal at Novorossiysk, was opened at the end of 1997 with a capacity of around 100,000 b/d. From the beginning of 1999 a spate of deliberate explosion and technical problems rapidly made the pipeline unusable, and it was effectively closed in July.

From September 1999 fighting in Chechnya, through which the pipeline runs, made a rapid resumption in its operation unlikely. As a stopgap measure some oil was transported part of the way through the pipeline, loaded onto trains in Dagestan and carried along a route avoiding Chechnya, and then put back into the pipeline, but this method was of limited effectiveness. The Russian government proposed to build a new section of pipeline to skirt Chechnya, but this did not offer a rapid solution, either. ("Supsa Terminal and Pipeline, Georgia/Azerbaijan", Online: Web)

The 1994 production-sharing agreement (PSA) signed with the Azerbaijan International Operating Company (AIOC) was the first oil contract signed with Western firms, and so far has been the most important. By 2005, 16 such contracts have been signed. The most important are listed in the next page:
Table 2
Offshore Production Sharing Agreements

<table>
<thead>
<tr>
<th>Name of PSA</th>
<th>Project Partners</th>
<th>Estimated Reserves</th>
<th>Projected Investment</th>
<th>Project Status</th>
</tr>
</thead>
<tbody>
<tr>
<td>Azeri, Chirag, and Deepwater Gunashli (Azerbaijan International Operating Company, AIOC)</td>
<td>BP (34.1%, operator), Chevron-Texaco (10.2%), Lukoil (10%), SOCAR (10%), Statoil (8.6%), ExxonMobil (8%), TPAO (6.8%), Devon Energy (5.6%), Itochu (3.9%), Amerada Hess (2.7%)</td>
<td>6.5 billion barrels of oil and 140 Bcf of has</td>
<td>$20 billion</td>
<td>Exports began late 1997. AIOC expects 674,000 barrels per day (33 million tonnes pa) from the four platforms in total for the full year. Of this, 131,000 barrels per day is expected from Chirag, 239,500 barrels per day from Central Azeri, 177,500 barrels per day from West Azeri and 126,000 barrels per day from East Azeri.</td>
</tr>
<tr>
<td>Shah Deniz</td>
<td>BP (25.5%, operator), Statoil (25.5%), SOCAR (10%), LukAgip (10%), TotalFinaElf (10%), OIEC of Iran (10.0%), TPAO (9.0%)</td>
<td>2.5 billion barrels of condensate; 22 Tcf (630 Bcm) of natural gas</td>
<td>Over $3 billion</td>
<td>Consortium plans to produce an average of around 63,000 barrels of oil equivalent per day (or 2.8 billion cubic mtrs of gas and 0.8 million tons of condensate for the entire year) during 2007. Plateau production from Stage 1 will be 8.6 billion cubic mtrs of gas per annum and approximately 45,000 barrels of condensate per day.</td>
</tr>
<tr>
<td>Lankaran-Talysh</td>
<td>TotalFinaElf (35%, operator), Wintershall (30%), SOCAR (25%), OIEC of Iran (10%)</td>
<td>700 million barrels of oil</td>
<td>$2 billion $36.6 million invested by 2000</td>
<td>First test well (2001) came up dry.</td>
</tr>
<tr>
<td>Field</td>
<td>Operator Shares</td>
<td>Well Results</td>
<td>Compensation</td>
<td>Notes</td>
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<td>------------------------</td>
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<tr>
<td>Yalama/D-222 Lukoil</td>
<td>(80%), SOCAR (20%)</td>
<td>750 million barrels at Yalama field</td>
<td>$2.5-5.5 billion</td>
<td>Drilling to 4,400 meters failed to find commercial reserves. Lukoil does not plan to return to exploration drilling until 2008. Lukoil has a commitment with SOCAR to drill the second well.</td>
</tr>
<tr>
<td>Absheron</td>
<td>SOCAR (50%); Chevron (30%, operator), TotalFinaElf (20%)</td>
<td>858 million barrels of oil; up to 100 Tcf of natural gas</td>
<td>$3.5 billion; $10.6 million invested by 2000.</td>
<td>Project closed. Chevron abandoned first exploratory well in 2001. In November 2003, Chevron and Total paid $40 million in compensation rather than drill a second well as required under contract.</td>
</tr>
<tr>
<td>Oguz</td>
<td>ExxonMobil (50%, operator), SOCAR (50%)</td>
<td>290 million barrels of oil and 685 bcf of gas</td>
<td>$2 billion; $5.5 million invested by 2000.</td>
<td>Dry well drilled in April 2001. ExxonMobil announced plans to quit the project in April 2002.</td>
</tr>
<tr>
<td>Nakhchivan</td>
<td>ExxonMobil (50%, operator), SOCAR (50%)</td>
<td>750 million barrels of oil</td>
<td>$2 billion; $22.5 million invested by 2000</td>
<td>ExxonMobil drilled one well but decided not to take the risk of drilling the second exploration and will pay $18 million in compensation to Azerbaijan since no commercial hydrocarbons were found.</td>
</tr>
<tr>
<td>Kurchachi-Araz-Kirgan Daniz</td>
<td>SOCAR (50%), Agip (25%, operator), Mitsui (15%), TPAO (5%), Repsol (5%)</td>
<td>730 million barrels of oil</td>
<td>$2.5 billion</td>
<td>First test wells drilled, with poor results. Italy's Agip paid compensation to Azerbaijan to be released from the PSA.</td>
</tr>
<tr>
<td>Field</td>
<td>Operator</td>
<td>たくさん</td>
<td>barrels of oil</td>
<td>Investment</td>
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<tr>
<td>Inam</td>
<td>SOCAR (50%), BP (25%), Royal Dutch/Shell (25%)</td>
<td>2.2 billion</td>
<td>$2 billion; $7.5 million invested by 2000</td>
<td>BP suspended drilling of its first appraisal well in Aug. 2001 due to high pressure. New well is planned to begin drilling when a rig currently digging the Shah Deniz field becomes available.</td>
</tr>
<tr>
<td>Araz, Alov, and Sharg</td>
<td>SOCAR (40%), BP (15%), Statoil (15%), ExxonMobil (15%), TPAO (10%), Alberta Energy (5%)</td>
<td>6.6 billion</td>
<td>$10 billion</td>
<td>In exploring phase in 2004. Confrontation with Iranian gunboat in July 2001; exploration suspended, pending resolution of Caspian Sea borders between Azerbaijan and Iran.</td>
</tr>
<tr>
<td>Atashgah</td>
<td>SOCAR (50%), JAOC consortium (50%). JAOC divided as Japex (22.5%), operator, Inpex (12.5%), Teikoku (7.5%), and Itochu (7.5%)</td>
<td>600 million</td>
<td>$2.3 billion; $35 million invested in 1999.</td>
<td>Seismic work being undertaken. Second well at the Yanan-Tava field, part of a concession that also includes Ateshgah and Mungan-Deniz, struck gas, but not enough to be commercial. In June 2003, JAOC announced it would leave Azerbaijan.</td>
</tr>
<tr>
<td>Lerik, Jenab, Savalan, Dalga</td>
<td>SOCAR (50%), ExxonMobil (30%), unassigned (20%)</td>
<td>1 billion</td>
<td>$3 billion</td>
<td>Exploration D-43, D-44, and D-73 blocks.</td>
</tr>
<tr>
<td>Zafar-Mashal</td>
<td>SOCAR (50%), ExxonMobil (30%), Conoco (20%)</td>
<td>1.2 billion barrels of oil, 1.8 tcf gas</td>
<td>$3 billion</td>
<td>Exploration D-9 and D-38 blocks. Reached final drilling point in September 2004, well likely to be</td>
</tr>
</tbody>
</table>
shut down due to abnormally high pressure, and Exxon-Mobil failed to reveal commercial hydrocarbon reserves. Exxon-Mobil paid $32 million to relinquish its license in 2006.

<table>
<thead>
<tr>
<th>Surakhani</th>
<th>Rafi Oil (75%), SOCAR (25%)</th>
<th>50 million barrels of oil</th>
<th>$400 million</th>
</tr>
</thead>
</table>

Contract states that oil production at the field should rise 50% in two years. Rafi Oil will finance SOCAR's stake in the project until it doubles the current rate of extraction. SOCAR will have the right to sever the contract if Rafi Oil does not start exploration within two years. This is initially a 25-year PSA with the possibility of a five-year extension.

<table>
<thead>
<tr>
<th>Name of PSA</th>
<th>Project Partners</th>
<th>Estimated Reserves</th>
<th>Projected Investment</th>
<th>Project Status</th>
</tr>
</thead>
<tbody>
<tr>
<td>Kalamaddin-Mishovdagh</td>
<td>Nations Petroleum (85%); SOCAR (15%)</td>
<td>200 million barrels of oil</td>
<td>$178 Million</td>
<td>Production averaged 5,000-7,000 bbl/d during 2007, but Nations Petroleum was</td>
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<td>(formerly AzPetoil JV)</td>
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<td>reportedly looking to sell its majority stake during 2007. EBRD also a partner.</td>
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<td>Signed as JV in 1992; converted into PSA in 2000</td>
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<tr>
<td>Mishovdagh Petroleum</td>
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<tr>
<td>Signed as JV in 1992; converted into a PSA in 2000</td>
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<tr>
<td>Anshad Petrol</td>
<td>SOCAR (51%), Attila Dogan (31.5%), Land and General Berhard (17.5%)</td>
<td>219 million barrels at Neftchala, Khilly, Babazanan</td>
<td>NA</td>
<td>Drilled 4 wells 1998-1999. Oil Production averaged 77,000 bpd in 2004. Gas production averaged 1.1 mcf/day for 2004.</td>
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<tr>
<td>Signed as JV in 1993; converted into a PSA in 2000</td>
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<tr>
<td>AzGeroil</td>
<td>SOCAR (51%), Grunewald (49%)</td>
<td>140 million barrels at Ramany, Balkhany, and Sabunchi fields</td>
<td>NA</td>
<td>Production averaged 1,000 bbl/d in 1999.</td>
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<tr>
<td>Signed as JV in 1995; converted into a PSA in 2000</td>
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<tr>
<td>Southwest Gobustan</td>
<td>SOCAR (20%), CNPC of China (62.83%) and Arawak Energy of Canada (37.17%)</td>
<td>147 million barrels of oil; up to 7 trillion cf of natural gas</td>
<td>$700 million</td>
<td>In Feb. 2006 2 wells are producing total of 1 mill. cubic feet/day, expecting to produce 10 mill. cubic feet/day.</td>
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<tr>
<td>Signed June 2, 1998; ratified November 1998</td>
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<tr>
<td>Zykh-Govsany</td>
<td>SOCAR (25%); Russneft(75%)</td>
<td>66-140 million barrels of oil</td>
<td>$150 million (new investment by Russneft)</td>
<td>Lukoil pulled out of investment due to high environmental costs, but Russneft plans to apply new technology to enhance oil recovery.</td>
</tr>
<tr>
<td>Kursangi-Garabagli</td>
<td>SOCAR (50%), CNPC (30%), Amerada Delta-Hess JV (20%)</td>
<td>182.5 million barrels of oil</td>
<td>$1 billion; proposed $50 million in 2006</td>
<td>10 additional wells drilled in 2003 to increase production; fields producing 6,600</td>
</tr>
<tr>
<td>Signed December 15, 1998; ratified</td>
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<tr>
<td>Area</td>
<td>Field/Operator Information</td>
<td>Oil Reserves/Project Details</td>
<td>Cost/Investment</td>
<td></td>
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<tr>
<td>April 1999</td>
<td>bbl/d in June 2004. 8 additional wells planned for 2006. Operators reportedly looking to send oil through BTC.</td>
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</tr>
<tr>
<td>Muradkhanli-Jafarli-Zardab</td>
<td>Ramco (50%, operator), SOCAR (50%)</td>
<td>730 million barrels of oil</td>
<td>$1 billion</td>
<td></td>
</tr>
<tr>
<td>Signed July 21, 1998; ratified November 1998</td>
<td>1st test well at Muradkhanli shut down in April 2001. CNPC won a tender to develop the block, although no new PSA has been signed yet.</td>
<td></td>
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</tr>
<tr>
<td>Padar-Kharami</td>
<td>Nations Petroleum (85%, operator), SOCAR (15%)</td>
<td>580-750 million barrels of oil</td>
<td>$140 million</td>
<td></td>
</tr>
<tr>
<td>Signed April 27, 1999</td>
<td>3-4 exploration wells planned for 2006. EBRD also a partner.</td>
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<tr>
<td>Shirvanoil</td>
<td>SOCAR (49%), Caspian Energy Group (UK) (51%)</td>
<td>650 million barrels of oil at Kyurovdag field</td>
<td>$36 million</td>
<td></td>
</tr>
<tr>
<td>Signed as JV in 1997; converted into a PSA in 2000</td>
<td>Rehabilitating existing wells since 1997. Has produced 11.6 million barrels of oil since 1997.</td>
<td></td>
<td></td>
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</tr>
<tr>
<td>West Absheron (Karadag-)</td>
<td>BMB (100%)</td>
<td>200 million barrels of oil</td>
<td>$700 million</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Project area including the fields Garadag, Kyorghex and Umbaki sold in a contract block to SOCAR in 1999. SOCAR subsidiary Azneft started pre-drilling programme at field in 2005</td>
<td></td>
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</tbody>
</table>

GLOBAL PURSUIT FOR AZERI OIL

Of the five littoral states, Azerbaijan has been the most attractive to foreign companies seeking to tap into the Caspian’s vast energy reserves. Azerbaijan’s sector of the Caspian is estimated to contain 25 of the 32 known oil and gas fields of the Sea as well as 145 of the 386 prospective structures, putting Azeri oil reserves at 3.6 billion proven and 27 billion possible barrels. Moreover, Baku’s offshore fields lie beneath relatively shallow water, thus allowing easier and cheaper oil extraction than is possible elsewhere in the Caspian.

Azerbaijan inherited a dilapidated oil industry and an almost nonexistent infrastructure from its seven decades as a Soviet republic. Although Azerbaijan was the main oil-producing region in the Soviet Union through the 1940s, Moscow concentrated on its Siberian fields beginning in the 1960s and never took any serious interest in developing Caucasian oil. As a result of which, oil fields of the region never got due attention from policy makers.

Because of the neglect of the Azeri oil industry by the central authorities in Moscow in the later years of the Soviet Union, Azerbaijan became an investment opportunity waiting for the political situation to change. In the years immediately following independence, Azerbaijan capitalised on foreign interest in its Caspian resources by attracting international investment.

In September 1994, the government of Azerbaijan signed a major US $8 billion contract with a consortium of oil companies from the United States, the United Kingdom, Norway, Turkey, Russia, Saudi Arabia, and Japan. The agreement, called the “Deal of the Century” by many commentators, provides for the exploitation of an estimated four billion barrels of oil in the offshore Gunesheli, Azeri, and Chirag fields on the Caspian shelf near Baku. Azerbaijan
economical system stipulates a growth of 7 to 8 per cent, and sometimes even more. (Nassibli, 1998, Online: Web)

Azerbaijan has made development of the oil industry the cornerstone of its national economic policy and the focus to reverse its steady economic decline since independence. It is estimated that the September 1994 oil contract alone would bring a profit of more than US$80 billion for Baku, and many of the contracts have included a signing bonus amounting to hundreds of millions of dollars. In addition, scores of new jobs will be created in the country; it is predicted that eventually 90 per cent of the professional staff and 95 per cent of the non-professional staff working on oil projects will be Azerbaijanis. There has been a surge in construction and renovation in Azerbaijan as foreign investors have begun to build infrastructure including pipelines, roads, railroads, office buildings, and hotels. Services necessary for business like a reliable phone service and the Internet are also becoming available. In order for Azerbaijan to realize fully the benefits of its oil development potential, it is essential that Baku retain sovereignty over its own affairs and its oil fields in particular. During decades of rule from Moscow, Azerbaijan saw little benefit from the oil that was taken from its offshore fields as the majority of its oil revenues were sent to Moscow. Baku is now relying on future offshore production to boost its economy. About eighty per cent of current Azeri production comes from offshore fields, and of all the contracts signed thus far or under negotiation with international oil companies, only the Kursangli and Karabagli structures are onshore. If Azerbaijan is denied sole ownership of its own sector of the Caspian, it will thus lose almost all international investment and most of its oil production. ("The Caspian Sea Status Dispute: Azerbaijani Perspectives" (1998), Online: Web)
Russian success in denying sectoral division of the Caspian would also impact negatively Azerbaijan’s political independence. Joint dominion over the Sea would empower the dominant regional actor, Russia, with the greatest voice in the exploitation of the Sea’s energy reserves and undercut the independent decision-making ability of the Azerbaijan and the other littoral states. Unable to develop its resources and thus to chart its own path to economic and political independence, Baku would again become a virtual client of Moscow. (Croissant and Croissant, 1998, pp.1-13)

Before the break up of the Soviet Union, the legal status of the Caspian Sea was established under Soviet-Iranian treaties signed in 1921 and 1940. After the break-up of the Soviet Union, the Caspian became the property of five countries, Russia in the north, Iran in the south, Kazakhstan and Turkmenistan in the east and Azerbaijan in the west. If the Caspian were to be given the status of a sea, it would be divided into territorial zones, with each country bordering it, and allowed control to even their own resources as per the 1982 Convention on Law of the Sea. This would allow the former Soviet Union states to have major shares of the Caspian hydrocarbon resources and to develop their own portion of the sea bed. However, if the Caspian is given the status of a lake, as Iran and Russia are claiming, it would be the common property of all the littoral states, which means that any exploitation of resources and navigation rights would be subject to agreement by all the five countries. (Croissant and Croissant, 1998, pp.15)

In 1992 and 1993, after the break-up, the Caspian littoral states met in Astrakhan and Tehran to discuss Caspian related issues such as regional development, the environment and fishing rights. On several occasions all the states, except Russia, agreed to a plan, formulated by Kazakhstan, and based on the old Soviet Republic boundaries, to divide the Caspian into individual
sectors bounded by equidistant lines from the shores of the bordering states. This was the de facto arrangement the new states had been using, and one which is consistent with the way other similar bodies of water are legally divided. Under such an arrangement few, if any, substantial resources would be in the Russian sector, and Russia announced its objections. In spring 1994, Yeltsin staff called for the classification of the Caspian as a condominium, with no sectoral divisions. This would mean that each littoral state could claim only resources, lying within 10 nautical miles of its shores, the rest being shared equally, among all littoral countries. Some legal experts believe that Russia would not be able to prove in an international court of law a condominium case for the Caspian, rather than a sectoral division, as is common for such bodies of water. (Croissant and Croissant, 1998, pp.15-19)

The government's principal policy challenge will be to maintain macroeconomic stability as the booming oil sector drives rapid economic growth. High oil prices and increasing oil export volumes will bring strong growth in budget revenue and expenditure. Double-digit growth in government spending will exacerbate inflationary pressures. Foreign-currency inflows from oil exports will strengthen the manat in nominal terms against the US dollar. Together with high inflation, this will produce a cumulative real effective appreciation of around 40% in 2008-09. (“Country Profile-Azerbaijan” Online: Web)

The government of Azerbaijan has established a new State Oil Fund to provide for economic stability and fund future economic development, particularly in the non-oil sectors of the economy. This fund is the only one of its kind within the CIS managed by an autonomous government agency. The government promises conservative, rational and transparent spending of oil
profits extracted from the Caspian Sea deposits. ("Azerbaijan’s Oil Fund Finances the Future", Online: Web)

Role of Azerbaijan on Caspian Energy Issue

Azerbaijan has been following a mixed policy of cooperation and resistance with regard to Russia particularly on the Caspian issue. The former President Elchibey was quite nationalistic and determined about ending of what he perceived as a "quasi-imperial" relationship with Russia. The next President Haider Aliev while showing accommodation with Russia on certain issue such as membership of the CIS, was firm on the Caspian issue. At the same time he welcomed the participation of Russian oil and gas companies such as Lukoil, Rosneft etc, in the international consortia for exploitation and transportation of oil to the world markets. However, to raise Azerbaijan’s strategic significance in the eyes of the Western powers, Aliev showed preference for Western oil giants such Amoco, Chevron, Mobil etc. By doing so, Aliev not only ensured easy access to liberal Western investment capital and most modern technology for development of energy sector of Azerbaijan but also sought to reduce dependence on Russia and its influence on his country’s policy. This paid dividend to Aliev in softening US policy towards Azerbaijan. The US had been favouring Armenia in the Nagorno Karabakh dispute. (Croissant and Croissant, 1998, pp. 30-34)

In 2007, Azerbaijan had to review its oil strategy. The country does not intend to confine itself to export crude oil. At the same time, plans to be actively involved in the production and marketing of ready processed products to the European markets. President Ilham Aliyev announced this during the signing of the MoU on energy cooperation between the EU and Azerbaijan in Brussels in November 2006. Govt agreed to modernise refinery factories in
Baku, with a view to produce gasoline on European standards. Acquisition terminal at Kulevi on the shores of the Black Sea will contribute to export finished products to the markets of Eastern Europe. Terminals at Ceyhan and in Romania will break Azeri oil to European and world markets. (Ibrahimov, 02 April 2007, Online: Web)

PIPELINE CONFLICT AND AZERBAIJAN

In the beginning, the West favoured the passage of a pipeline via the Karabakh part of Azerbaijan, Armenia, the Nakhichevan part of Azerbaijan and Turkey - hoping in this way to regulate the Karabakh conflict and free Armenia for Russia's influence. Although after the active intervention of the West in the conflict settlement: the creation of the Minsk Group of the (OSCE) in 1992; the joint American-Turkish-Russian initiative (3+1) in 1993; and the replacement of three states- the chairmen of the Minsk Group (Italy, Sweden, Finland), it became finally obvious that Armenia did not intend to give its consent to that route. Azerbaijan was categorically against it too following the activisation of the peacekeepers in autumn 1994.

At the same time Azerbaijan categorically rejected the route via Karabakh, Armenia, and Nakhichevan, to Turkey, considering that this would make the republic strongly dependent on the position of Armenia which was unacceptable for Aliev. Proceeding form this, the only routes left were the Georgian and the Russian. The position of Armenia and the attitude of

5 The OSCE Minsk Group was created in 1992 by the Conference on Security and Cooperation in Europe (CSCE), now Organization for Security and Co-operation in Europe (OSCE)) to encourage a peaceful, negotiated resolution to the conflict between Azerbaijan and Armenia over Nagorno-Karabakh. The main objectives of the Group are: i) Providing an appropriate framework for conflict resolution in the way of assuring the negotiation process supported by the Group; ii) Obtaining conclusion by the Parties of an agreement on the cessation of the armed conflict in order to permit the convening of the Minsk Conference; and iii) Promoting peace process by deploying OSCE multinational peacekeeping forces. See Online: Web http://en.wikipedia.org/wiki/OSCE_Minsk_Group
Azerbaijan and Turkey towards it were defined by the regulation of the Karabakh conflict. However, Turkey and Azerbaijan have different attitudes towards the Armenian route of the pipeline. As before, Ankara is tying up the normalisation of Armenian and Turkish relations with settling of the Karabakh conflict. But the demands of Turkey became no less categorical despite the unconcealed efforts of Azerbaijan to frustrate the rapprochement that had started.

**Pipeline Routes**

Many new oil and gas pipeline routes have been proposed in the last few years. However until these routes become reality, Russia will maintain its dominance through its controls only existing pipelines. Although many new routes have been proposed, for immediate future, two main routes have been very important. These routes link Caspian production with Black Sea and thereby, the Mediterranean Sea and European markets. The first one is the Caspian Sea Consortium’s (CPC) two billion US dollars project to upgrade and connect existing Russia pipelines to the Black Sea port of Novorossiysk via Chechnya. The second project was the result of an agreement between Russia and Azerbaijani International Oil Consortium (AIOC). The agreement gives permission to the member companies to use Russian pipelines to export oil through two alternative export pipelines routes from Baku. Export began in 1997 along a Northern route from Baku to Novorossiysk, the first of two “early oil” pipelines. Exports from second “early oil” route from Baku to Georgian Black Sea port of Supsa also started later on. These two routes have combined initial capacity of 200,000 bbl/d. In Baku Declaration in October 1998, Azerbaijan, Georgia, Kazakhstan and Uzbekistan has supported Baku-Ceyhan route as MER. On September 20th 1994 at Baku, ‘the deal of the century’ was signed when a consortium, Azerbaijan International Operating company
(AIOC) agreed to spend $7.4 billion to develop three major field: Azeri, Chirac and Guneshli was a vowed goal to produce 800,000 to one million barrels of oil a day by 2010. In the international oil sector the region has emerged as important factor recognized even by OPEC. The global competition and rivalry to have influence on region is today the theme of international debate. (Sachdeva, 2000, pp.147-148)

While formulating foreign policy, Baku has tried to keep the interest of Caspian littoral states. However this did not prevent Azerbaijan to pursue it’s own interest Therefore the cooperation of Azerbaijan with the Western Companies started already in 1990 during Mutalibov’s rule.

**Baku-Tbilisi-Ceyhan (BTC) Pipeline**

On May 25, 2005 Azerbaijan began filling the Azeri section of the long-awaited Baku-Tbilisi-Ceyhan (BTC) pipeline that runs 1,040 miles from the Azeri capital city of Baku, via Georgia, to the Mediterranean port of Ceyhan. At a cost of almost $4 billion, the BTC pipeline allows oil to bypass the crowded Bosporus and Dardanelles Straits and is also the first pipeline able to export oil from the Caspian Sea that does not cross Russian soil. Test filling began in early May 2005, and the BP-led consortium expects the first tanker loadings during the fourth quarter of 2005. For more information about the significance of the pipeline, please consult the Caspian country brief. (“Azerbaijan-Oil (Petroleum) Background”, June 2005, Online: Web); (“Baku-Tbilisi-Ceyhan Pipeline”, Online: Web)

Construction started for this pipeline in September 2002. The Pipeline was officially inaugurated July 13, 2006. It is expected to transport 1 million barrels of oil per day by 2008. Petrofac International was a major contractor in constructing the pipeline, pumping stations, pigging stations and block valve
stations in the Azerbaijan and Georgia sections. The route of the pipeline crosses Azerbaijan and skirts Armenia to pass through Georgia and Turkey. Of its total length of 1,760 km (1,094 miles), 440 km (273 mi) lies in Azerbaijan, 244.5 km (152 miles) in Georgia and 1,070 km (665 mi) in Turkey. It crosses several mountain ranges at altitudes of up to 2,830 m (9,300 ft). It also has to traverse 3,000 roads, railways and utility lines, both over ground and underground, as well as 1,500 watercourses of up to 500 m wide (in the case of the Ceyhan River in Turkey). ("Baku-Tbilisi-Ceyhan Pipeline", Online: Web)

Funding for the BTC pipeline was largely through the World Bank's International Finance Corporation and the European Bank for Reconstruction and Development. The cost has been reported at $3.6 billion, with the three principal stakeholders being BP (at 30.1%), AzBTC (a subsidiary of Azerbaijan's state-run oil company, at 20%) and the U.S. oil company Unocal (at 8.9%). Substantial transit fees will accrue to Georgia and Turkey, which are expected to produce for Georgia about 1.5% of national income. Azerbaijan expects its own economy to grow by 18% as a result of the pipeline. Turkey expects to obtain $200 million US per year in transit fees. ("Baku-Tbilisi-Ceyhan Pipeline", Online: Web)

The pipeline was officially opened on 25 May 2005 in the presence of President Nursultan Nazarbayev of Kazakhstan, President Ilham Aliyev of Azerbaijan, President Mikhail Saakashvili of Georgia, and President Ahmet Necdet Sezer of Turkey, as well as United States Secretary of Energy Samuel Bodman. By May 2006, oil had started to flow through the pipeline.

The government of Kazakhstan has announced that it would seek to build a trans-Caspian oil pipeline from the Kazakh port of Aktau to Baku in Azerbaijan, connecting with the BTC pipeline, to transport oil from the major
Kazakh oilfield at Kashagan as well as points further afield in Central Asia. However, due to opposition to any Caspian offshore pipelines by both Russia and Iran, the oil pipeline is not very realistic. Kazakhstan has announced construction of the US$1.6 billion Kazakh-Caspian Transportation System, which is scheduled to come into operation in 2010. The project includes a pipeline from Iskene to the Caspian port of Kuryk, terminals in Kazakhstan and Azerbaijan, and construction of oil tankers.

Oil that was pumped from the Baku end of the pipeline on 10 May 2005 reached Ceyhan in 28 May 2006 after a journey of 1,770 kms. The first oil was loaded from Haydar Aliyev Sea Terminal onto a ship named The British Hawthorn. The tanker sailed away from the new Ceyhan Marine Terminal on the Mediterranean coast on 4 June 2006 with about 600,000 barrels of crude oil. This marked the start of export of Azerbaijan's oil via the BTC oil pipeline to world markets, bypassing the Turkish straits (Bosphorus and Dardanelles). ("Baku-Tbilisi-Ceyhan Pipeline", Online: Web)

The BTC pipeline is expected to make a major contribution to the development of world energy supply with its annual 50 million ton capacity. Thanks to this project, which was created with a sustainable environmental and economic system, Turkey is also expected to earn about $300 million annually. Around 15,000 people were employed during the construction of the pipeline which cost over $3 billion. The project constituted an important leg of the East-West energy corridor, gaining Turkey greater geopolitical importance thanks to the BTC pipeline. Ceyhan will be an important international oil market and the reduction of oil tanker traffic on the Bosphorus will contribute to greater security for Istanbul. Georgia has also welcomed the development. The BTC will not only contribute to the Georgian economy, it also supports Georgia's independence from Russian influence. Russia has become aggravated
over the situation and have even been accused of a plot to sabotage the pipeline. Azerbaijan with the BTC gained a direct connection to international energy markets. The South Caucasus gas pipeline, using same route as the BTC, came operational at the end of 2006. ("Baku-Tbilisi-Ceyhan Pipeline", Online: Web)

**Figure 1**

![Baku-Tbilisi-Ceyhan Pipeline Map](http://www.azerb.com/az-btc.html)

AGREEMENTS AND JOINT VENTURES

To utilize fully, its natural resources, Azerbaijan initiated a chain of agreements with different international energy companies. An agreement about joint oil extraction in the Azeri section of the Caspian Sea was signed between Russia and Azerbaijan (23 October, 1993-Iyri Shafranik's - the Minister of Fuel and Energy of the RF-vist) and out of the 30 per cent share of Azerbaijan in the consortium, 10 per cent was passed onto the Russian state company 'Lukoil'; furthermore, for the joint elaboration the Gyuneshli deposit was singled out (with a capacity of $ 1, 4 billion barrels), which till October 1993 was assumed to have been included in the contract with the Western companies. Thus, distinct from the rejected option of June 1993, in the new project the working out of two and not three deposits has been considered, those of Azeri and Chirag, estimated at $7-10 billion (the peak of extraction, several years after the beginning of implementation will be approximately 30-40 million tons per annum). In December 1993, sources in Baku referring to the opinion of experts of the Azerbaijan government were assuming that the contract with the consortium of the Western companies did not correspond to the economic interests of Azerbaijan and not likely would be rejected. Probably they were close to the truth: representatives of the Turkish government supposed that Aliyev had already given consent for the transportation of most or all of the oil via Novorossyiysk. Natig Aliyev, the President of the State Oil Company of the Azerbaijan Republic (SOCAR) had to deny information that in the course of Shafranik's visit to Baku a secret agreement has been signed which envisaged the implementation of the project of the oil pipeline construction according to the Russian version.

The Government of Azerbaijan and BP signed in Baku a Bilateral Security Protocol which would govern the provision of security for BP-
operated oil and gas projects in Azerbaijan. The protocol covers the provision of security for BP-operated facilities and installations: the Baku-Tbilisi-Ceyhan (BTC) and South Caucasus Pipeline (SCP) projects, the Western Route Export Pipeline (WREP), the Northern Route Export Pipeline (NREP), the installations associated with the offshore Shah Deniz and ACG (Azeri, Chirag and Deepwater Gunashli) fields, as well as related onshore installations located at the Sangachal Terminal. The protocol aims also to promote respect for and compliance with internationally recognized human rights principles. Specifically the Bilateral Security Protocol defines standards and procedures on the use of force and firearms, hiring and training security personnel, consultation and exchange of information, and monitoring compliance. The signing of the Protocol fulfils the commitment undertaken by the Governments of Azerbaijan, Georgia and Turkey and BTC Co set forth in the BTC Joint Statement, of May 2003. In the Statement, the parties declared their mutual commitment to promoting respect for and compliance with human rights standards through signing protocols to the Intergovernmental Agreement (IGA) and Host Government Agreements (HGAs). ("Azerbaijan Government and BP Sign Bilateral Security Protocol", 13 November 2007, Online: Web)

The latest Azerbaijan Oil & Gas Report from BMI forecasts that the country will account for 2.60% of Central and Eastern European (CEE) regional oil demand by 2011, while providing 8.54% of supply. CEE regional oil demand rose to an estimated 5.21mn barrels per day (b/d) last year and should average 5.35mn b/d in 2007, before reaching 5.97mn b/d by 2011. Production of an estimated 12.41mn b/d last year is forecast to reach 15.22mn b/d by 2011. CEE gas consumption in 2006 was an estimated 587bn cubic metres (bcm), with demand of 715bcm targeted for 2011. Production last year of an estimated 680bcm should reach 758bcm by the end of the period.
Azerbaijan’s share of consumption in 2006 was an estimated 1.70%, while its share of production was just 0.88%. By 2011, its share of demand is forecast to be 1.96%, with the country accounting for 2.64% of supply. For the whole of last year, our estimates of average crude oil prices are US$61.10 for the OPEC basket, US $65.10 for Brent, US $66.20 per barrel (/bbl) for WTI and US$61.30 for Urals. For the first quarter of this year, we have adjusted our forecasts to reflect the weather-induced volatility. The OPEC basket is now expected to have averaged US$54.30/bbl, with Brent at US$57.60; WTI averaging US$58.70 and Urals at US$54.00/bbl. Our projections for 2007 as a whole are barely changed from the last quarterly report. We are still assuming an OPEC basket price average of US$55/bbl. Based on last year’s typical price differentials, this implies Brent at US$58.80, WTI averaging US$59.90/bbl, and Urals at US$55.30/bbl. Azeri real GDP growth is now forecast by BMI at 26.7% for 2007, following 34.5% in 2006. We are assuming 22.5% growth in 2008, followed by 17.9% in 2009, 15.0% in 2010 and 11.5% in 2011. Domestic consumption, having tumbled since the 1990s, should now have resumed a growth tack, estimated at an average 7% per annum. By 2011, the country could be using 155,000b/d of oil. Main government vehicle Socar currently accounts for half of domestic oil production but, in partnership with international oil companies (IOCs), should raise national output from an estimated 570,000b/d last year to 1.3mn b/d by 2010/11. (“Azerbaijan Oil and Gas Report 2008” Online: Web)

AZERI OIL AND EXTERNAL POWERS

Haider Aliev thought that oil will be one of the important factors and will be the main driving force for its economic future and that of rapprochement with the West. It was also connected with the Armenian-Azeri conflict regulation, each aggravation of which coincided with the next stage of
the negotiations about the consortium. The contract, which would bring the oil extraction in the Republic (in 1996 -10.25 million tons per annum) to the level of a small Persian Gulf state, would take Azeri interests into account. Thus, transnational oil companies (USA: 'Amoco' 17.01 per cent, 'Pennzoli' 9.82, 'Uncocal' 9.52, 'Mcdermott' -2.45; Great Britain: 'British petroleum' -17.13, 'Aramco' -2.08; Norway: 'Statoil'-8.56; Russia: 'Lukoli' -10; Azerbaijan: 'SOCAR'-20; Turkey: 'Turkish Petroleum' -1.75; Saudi Arabia: Delta Nimirand' -1.68) investing finance and technology would be interested in peace and political stability in Azerbaijan. Negotiations also continued with the alliance of 'BP' -"Statoli' and with Turkish Petroleum about the right to prospect and cultivate the gigantic deposits of Shak-Deniz (estimated at 5-6 billion barrels of accessible oil). The contract also had great political significance. The leading countries of Europe and the USA would pay significant attention to the problem of provision of stability in Azerbaijan and throughout the region, because destabilisation of the situation in this Transcaucasian republic will threaten the activity of the Western oil companies. (Shorokhov, 1996, p. 28) Thus the contract fixed the long term orientation of Azerbaijan towards the West and launched new stages of relations with the USA and Russia, which was clearly shown by the negotiations at the 49th General Assembly of the UN.

A closer evaluation of geopolitics of this region shows that external powers like Russia is trying to maintain it's stronghold in this region, while USA, with it's new found allies like Turkey and Azerbaijan, is trying to make it's presence felt in this part of the world. However, it is not only the external actors complicating the situation but internal ethnic complexities are also accentuating the geo-politics of Caucasus in general and Azerbaijan in particular.