



Economic And Security Values of Caspian Energy for Azerbaijan

Güner Özkan*

Abstract

The amount of proven oil and gas reserves of Azerbaijan is enough for reviving the shattered socio-economic infrastructure of the country. The government has used regularly the income generated from the energy resources to ease the sufferings of the displaced Azerbaijanis, to improve overall life standards of the people and to reduce the environmental pollution in the country. Yet it is clear that there is still a long way to go in the development of almost all sphere of life in Azerbaijan. The role of energy resources on the external security and internal political process of Azerbaijan is much more important than it has played in the economic sphere. For Ebulfez Elchibey and Haydar Aliyev, regardless of their differences in policy preferences, energy contracts and pipelines were the most important diplomatic means to prevent Russia from gaining further military and political control over the country, and to restore the losses against Armenia in the Nagorno-Karabakh war. Though they were to some extent successful in stopping Russia, the same cannot be said on the NK issue against Armenia. Energy contracts of Azerbaijan have remained ineffective to induce either the West, the US in particular, or Russia to resolve the NK dispute. On the other hand, in the domestic arena, energy resources of the country have become the main tool in the hands of Aliyev family first to maintain and then to strengthen their political positions. Today development of Azerbaijan's Caspian energy resources has only maintained the regional status quo established in 1994 on the external security matters, and yet failed to boost socio-economic and political transformation in the country.

Keywords: Azerbaijan, Energy, Caspian, Caucasus, Security, Haydar Aliyev, APF

INTRODUCTION

The Caspian region was well-known to be rich in natural resources. During the Soviet period, Azerbaijan did not benefit much enough from its resources unlike its enormous

* Asst. Prof. Muğla University, Faculty of Economics and Administrative Sciences, Department of International Relations

contribution to the Soviet economic and military development. It is estimated that, from the middle of the 19th century to independence in 1991, oil production from Azerbaijan exceeded over one billion tonnes. What Post-independence Azerbaijan inherited from the Soviet past was a backward oil and chemical industry, and a heavily polluted environment. Nevertheless, up to the end of the 1980s, Azerbaijan continued to provide 70 per cent of the tools used in the Soviet oil industry.¹ The Oil Academy in Baku had a privileged position, as it was the first and the best centre for the education of the cadres in the oil industry in the USSR. Despite these advantages, the decline in oil production in Azerbaijan could not be reversed. The replacement of onshore oil fields with offshore fields in the Caspian was already underway, and these fields constituted 57 per cent of the estimated 13 million tonnes of oil Azerbaijan produced in the late 1980s.²

For the first time in its history, Azerbaijan had the chance to take control of the energy resources located within its own territory, and to use them for the benefit of its people. On the other hand, however, collapse of the USSR further broke down already shattered political and economic structures of the republic, leaving Azerbaijan with an enormous task of restructuring and rebuilding the country. The war over the Nagorno-Karabakh (NK) region with Armenia, which created political turmoil and huge social and economic misery with over a million displaced people in the country, has worsened the situation in Azerbaijan. When the new geopolitical nature of the post-Soviet Caucasus is added to all these, security perception of Azerbaijan has elevated the Caspian energy resources to a much higher place. This has comprised of getting rid of socio-economic miseries, environmental degradation of the country and reshaping regional geopolitical structure. It became obvious in a short period after independence that economic, social and environmental problems of Azerbaijan inherited from the past could not be resolved so long as the country has felt insecure and threatened by Armenia and Russia. Especially Armenian aggression on the NK issue has severely influenced the Azerbaijan's territorial security, socio-economic well-being and demographic integrity since 1991. As well as having the potential to fuel Azerbaijan's socio-economic development, the Caspian energy resources are powerful levers in reshaping Azerbaijan's geopolitical strategy and in dealing with its security problem. As a prominent Azerbaijani political analyst and politician, Nesibli, noted, "the hopes of the Azerbaijani people in the establishment of democratic institutions, reinstatement of the territorial integrity of the country and the increase of the well-being of the society are highly dependent on the development of energy resources of Azerbaijan."³

Since just before independence, Azerbaijani leaders have been well aware of the importance of the Caspian energy resources for the security of the new state. Muttalibov, Elchibey and finally Haydar Aliyev began negotiations with western (primarily American and British) oil companies about developing Azerbaijan's energy resources. These talks included not only the multinational oil companies, but also the

¹ Memmedov, A.S., 'Xezerdenizneftdonanma Idaresinin Denizde Neftgazcixarmnin Inkisafinda Rolu', *Azerbaycan Neft Teserrufati*, No.10, 1999, pp.33-36; Camalov, Y.T., 'Neft Sahesinin Inkisafinda Elmi-Texniki Nailiyetlerin Qabaqçil Tecrubenin Isiglandirilmesi ve Kadrlarin Hazirlanmasi', *Azerbaycan Neft Teserrufati*, No.1, 2001, pp.2-8

² *World Bank Country Study: Azerbaijan*, 1993, p.115; Halilov, I., and Caferov, R.R., 'Xazer Denizinin Azerbaycan Sektorunda Neft-Gaz Yataglarinin Senaye Menimsenilmesinin Vaziyeti ve Perspektivliyi', *Azerbaycan Neft Teserrufati*, No-8-9, 1999, pp.39-47

³ Nesibli, N., *Azerbaycan Geopolitikasi ve Neft*, (Baki: Khazer Universitesi Nesriyati, 2000), p.10

governments of the US, Britain, Russia, Turkey, Iran and many other countries. From Azerbaijan's point of view, both the development of its energy resources by multinational oil companies and stronger states and the pipeline issue could not, and should not, be divorced from the security problems of the state.

The main objective of this study is to assess why, and to what extent, the external security and internal stability of Azerbaijan are linked to the development of the energy resources in the Caspian. This work is divided into 3 main parts. The first part assesses the Caspian energy reserves of Azerbaijan in comparison with those of the other oil producing regions with a specific emphasis on the other energy rich Caspian states. This assessment is important because while it will give an idea of the energy reserves of Azerbaijan and Caspian region as a whole, it at the same time allows one to understand better the following parts of this research. The second part examines the economic importance of the Caspian energy resources. In this, the question of why Caspian energy resources are so important for Azerbaijan will be discussed from economic viewpoint. The third part, which consists of three sub-sections of Elchibey and Haydar Aliyev periods, and energy development as a political tool in Azerbaijan, delves into security value of the development of energy resources for both geopolitical and domestic terms. The first two sub-sections are to identify the Azerbaijani governments' reasoning of security strategies based on the country's Caspian energy resources. The third sub-section is to look at the role of the same energy issues on Azerbaijan's political stability. There are many examples of oil producing countries where oil revenues controlled by one particular political group are used for their own benefits rather than for the benefit of society. Oil revenues in such countries become an instrument in the hands of ruling elite and a source of domestic instability. Azerbaijan may not be an exception in this respect.

THE CASPIAN ENERGY RESERVES OF AZERBAIJAN IN PERSPECTIVE

It is often stated that while the three riparian states of Kazakhstan, Azerbaijan and Turkmenistan contain a significant amount of oil and gas, the other two, Russia and Iran, do not. The overall energy reserves of Azerbaijan, Kazakhstan and Turkmenistan are often compared with either those of the Persian Gulf or the North Sea. Regardless of its exact amount of energy resources, even proven deposits are undoubtedly of great significance for the economic recovery of Azerbaijan.

The percentage of proven oil and gas reserves of the Caspian region is much lower than that of the Persian Gulf. According to statistics, the Persian Gulf states of Saudi Arabia, Iran, Iraq, Kuwait and the United Arab Emirates (UAE) have the biggest proven oil reserves in the world with 673.7 billion barrels (bb), while the Former Soviet region as a whole has 65.4 bb. As far as the proven gas deposits are concerned, the territory of the former Soviet Union has the biggest reserves with 56.7 trillion cubic metres (tcm), while the Middle East comes second with 49.5 tcm. In both the proven oil and gas reserves of the former Soviet Union, the Russian Federation's deposits in onshore areas in Siberia and in other regions are far greater than those of the other Caspian States. Proven oil and gas deposits of Russia exceed up to 50 bb of oil and 1.700 trillion cubic feet (tcf) of natural gas, while Azerbaijan, Kazakhstan and Turkmenistan have 11, 16 and

1.4 bb of oil and 30, 65, 101 tcf of gas deposits, respectively.⁴ It is assumed that the potential onshore and offshore oil and gas deposits of Azerbaijan, Kazakhstan and Turkmenistan may rise to 38, 101, 33.5 bb of oil and 35, 88, 159 tcf of gas, respectively, in the future.

Since 1997, in the Russian part of the Caspian, LUKoil has carried out exploratory drillings at the *Severny, Astrakhan-Kalmykia* Shelf and Western Part of the Northern *Kulali* Bank and *Zyudev*, which are estimated to contain up to 850 million tonnes of oil (about 6 bb). For Russian experts, the economic efficiency of these fields is quite high, as long as the price of one barrel of oil remains above \$16.⁵ In the Iranian part of the Caspian, the Iranian News Agency (IRNA), relying on the information of the Iranian National Oil Company (INOC), announced that exploratory work conducted by the Lasmo and R.D. Shell companies for 18 months found an estimated 10 bb of oil and 560 bcm of gas in an area of about 10 thousand square km.⁶ Despite this announcement, however, the presence of oil and gas reserves of a similar scale in the Iranian section of the Caspian Sea has not yet been confirmed.

Perhaps the most spectacular oil discovery ever made in the Caspian in last decade is in the Kazakh sector of the offshore Kashagan region by the Offshore Kazakhstan International Operating Consortium (OKIOC) in summer 2000. In November 2001, the Italian oil company Agip, one of the shareholders in the OKIOC, confirmed that the Kashagan field contained at least 26 bb of oil reserves, while some Kazakh officials' and independent observers' estimates have gone up to 40-50 bb for the same area.⁷ For the Kazakh officials, energy deposits under Kazakhstan's section of the Caspian Sea may well reach up to 13 billion tonnes (over 90 bb) of oil and 6 tcm of gas.⁸ Until the discovery of the Kashagan field, major oil and gas deposits of Kazakhstan were known to be located in the onshore areas of *Tengiz, Karachaganak, Korolevskoye, Kenbay* and *Uzen*. Among these, the Tengiz region, where mass production of oil began in 2004, contains the most promising oil deposits.⁹

Turkmen sector of the Caspian has remained relatively unexplored. Nevertheless, the region has a similar geologic structure to that of the Azerbaijani part. Turkmenistan is known for its huge gas reserves in onshore fields and a limited amount of oil deposits in both offshore and onshore areas. For Turkmen officials, Turkmenistan's proven oil deposits go up to 12 billion tonnes, alongside its already assured huge gas reserves.¹⁰ The energy reserves of Turkmenistan attracted the companies of Bridas from Argentina,

⁴ For statistics, see Cordesman, Anthony H., 'The Changing Geopolitics of Energy: Regional Developments in the FSU, Russia, Central Asia and Caspian', *Center for Strategic and International Studies* (CSIS), 12/8/1998, pp.9-10; Cordesman, Anthony, H., 'The Shifting Geopolitics of Energy: Fuel Choice, Supply and Reliability in the Early 21st Century', *Center for Strategic and International Studies* (CSIS), October 2000, p.25, p.31, p.41; BP Statistical Review of World Energy June 2005, p.4, p.20

⁵ Zakharov, Y. and Glukhova, N., 'Development of North Shelf Economically Effective', *Caspian Energy*, No. 3(10), August-September 2001, pp.95-97

⁶ 'Azeri Press Reports Iranian Discovery of Oil and Gas Fields in Caspian', IRNA, 24/1/2001

⁷ Pala, C., 'OKIOC Strikes Oil Again in Caspian Sea', *Moscow Times*, 15/3/2001, p.7; *The Azeri Times*, 9-15/11/2001; Withbread, S., 'Caspian Staging a Comeback', *Offshore Engineer*, June 2000, p.39

⁸ Interview with Rashid Turarovich Ibrayev, the Ambassador of Kazakhstan to Baku, *Caspian Energy*, No.1(4), spring 2000, p.52

⁹ *Caspian Energy*, No. 2(9), April-May 2001, p.18; Kemp, J., 'Energy Superbowl: Strategic Politics and the Persian Gulf and Caspian Basin', *Nixon Center for Peace and Freedom*, Washington D.C., 1997, p.31

¹⁰ Interview with Chariyev Murad Baltayevich, the Ambassador of Turkmenistan to Baku, *Caspian Energy*, No.1(4), spring 2000, p.60

Lamarg Energy Associates from the Netherlands, and Dragon Oil from Ireland, which all engaged in the development of the oil fields in *Keimir*, *Ekpatlaukh*, *Chishlyar*, *Cheleken* and several other sites in the country. Turkmen gas reserves in the fields of *Dauletabad-Donmez* in the *Amu Darya* region through the Turkmen–Uzbek border, and *Yaslar* in the *Murgab* region, have been developed by the companies of Unocal, Delta, Gasprom and Bidas.¹¹

As for Azerbaijan, from September 20, 1994 to January, 2004, it signed 22 Production Sharing Agreements (PSA) with oil companies coming from intra- and extra-regional states. The first and biggest contract, called 'the Contract of the Century,' is for the development of the Azeri, Chirag and deep-water portion of the Gunashli fields (ACG). These three deposits contain about 630 million tonnes of oil, signed by 9 oil companies that formed the Azerbaijan International Operating Company (AIOC) and led by BP-Amoco as the operator company. The estimated volume of investment for the development of this combined field will be around \$11-12 billion over a period of 30 years. Expected profits from the ACG during this time period is about \$120 billion, 80 per cent of which will go to the Azerbaijani government (depending on the fluctuation of oil prices in the international market).

On the other offshore oil and gas fields of Azerbaijan, most of which, including ACG, were discovered during the Soviet period, contractors have undertaken geological studies and seismic surveys. In addition to this, according to the director of the Technical and Educational Department of the State Oil Industry of Azerbaijan, M. Bagirov, there were 4,000 onshore oil wells in 1995, which either stopped functioning or reduced production, owing to the exhaustion of deposits and lack of finance and technology. According to M. Bagirov, more than 35 onshore oil deposits, which were still producing a low yield, contained up to 2 billion tonnes of oil.¹² Despite difficulties, 0.6 million tonnes of oil was obtained from 19 onshore oil deposits in 2000.¹³ The Russian LUKoil company, which has shares in AIOC, Shahdeniz, Yalama and ZykH-Hovsani, for instance, has spent over \$500 million in Azerbaijan since 1993.¹⁴

Despite the fact that most oil areas are still in the processes of exploration, some of these works have confirmed that various fields do not contain enough oil and gas deposits. In five fields, Karabagli, Kurdashi, Araz, Nakhchivan and Ateshgakh no oil was found in the drillings from 1998 to 2003, and just 23 bcm of gas in the first area. After two successive drills for oil were failed in the Kurdashi offshore oil field, the Italian oil company Fina, which had 25 per cent share in the consortium for the development of it, quitted the consortium.¹⁵ However, in June 1999 continuing exploration work by BP-Amoco in the Shahdeniz offshore area, which was given to that company in 1996, found over 1 tcm of gas and 150 million tonnes of condensate.¹⁶ Shareholder companies spent about \$400 million on the development of the Shahdeniz field up to

¹¹ 'The Geopolitics of Energy in the Former Soviet Union', *Center for Strategic and International Studies*, (CSIS), Washington D.C., 11/2/1999; Kemp, J., 'Energy Superbowl...', op cit., pp.32-33

¹² Bagirov, M., 'Neft Senayesinin ve Neft Elminin Vacib Problemleri', *Azerbaijan*, 26/9/1995

¹³ The Oil and Gas Industry of Azerbaijan, (Baku: SOCAR, 2001), p.27

¹⁴ Russian LukOil company sold its 10 per cent share in the AIOC to the Japanese Inpex company for the price of \$1.375 billion in April 2003

¹⁵ *Azadliq*, 5/12/1998; *Azadliq*, 1-3/7/2000; *Azerbaijan Daily Digest*, 5/12/2001; *Azerbaijan Daily Digest*, 26/2/2002; *Azerbaijan Daily Digest*, 19/3/2003

¹⁶ BP-Amoco, Press Release, 12/7/1999

2000, and the investment volume for this field is expected to reach \$9 billion. One of the positive aspects of the Shahdeniz project is that the yield from it will be sold to a very close market in Turkey. After related intergovernmental agreements on sales, purchase and passage between Turkey, Azerbaijan and Georgia were completed by September 2001, despite some delay, construction of the gas pipeline to carry Shahdeniz gas to Turkey started in 2004. According to the agreements related to the Shahdeniz gas, Azerbaijan will be exporting 6.6 bcm of gas to Turkey, through the Baku-Tiflis-Erzurum (BTE) pipeline, and the export volume will be increased to 16 bcm over a period of 15 years.¹⁷

In comparison with the Persian Gulf states, as seen above, the Caspian region contains a modest level of proven energy resources. Azerbaijan after Kazakhstan seemed to have the biggest oil reserves in the region. However, these volumes are all expected to change since most of the Caspian region has yet to be explored. Even the existing 22 oil and gas contracts made between the Azerbaijani government and 33 companies from 15 states around the world are believed to provide Azerbaijan with at least \$ 210 billion from 1997 for the next 30 years.¹⁸

THE ECONOMIC IMPORTANCE OF CASPIAN ENERGY RESOURCES FOR AZERBAIJAN

The real economic boost from energy sector is expected to begin when the phases of the ACG project are completed in 2008 in accordance with the PSA between the AIOC and the government signed in 1994. Since the early 1990s, Azerbaijani governments have expected the Caspian energy resources to bring vital foreign investment for the revival of the impoverished country.

While the oil and fuel sector accounted for 14 per cent of total industrial output in 1990 in Azerbaijan, this figure increased to 82 per cent at the end of 1999. The year 2000 witnessed, in comparison to 1999, an increase of 20 per cent in oil and gas production, which led to the expansion of power generation (15 per cent), petrochemical production (16.1 per cent) and a modest growth in non-ferrous metallurgy and food industries.¹⁹ Since industrial output in Azerbaijan depends on oil production, then oil prices in the international market are of great significance for the overall economic development of the country. Owing to the high oil prices in the international market during 2000 (about \$27.5 per barrel), revenues from oil exports reached \$1.5 billion, which was two times higher than that of 1999. As a result of high oil prices in the international market, for the first time since 1991 Azerbaijan achieved the targets for consolidated budget revenues and grants in 2000.²⁰ However, increased dependency on oil-related revenues carries the risk of making the state budget and overall economy more sensitive to the fluctuation of oil prices in world markets.

The SOCAR (State Oil Company of Azerbaijan), which was incorporated in 1992 by combining the oil-producing and refining agencies of Azerbaijan, has provided

¹⁷ BP, *Press Release*, 14/3/2001; BP, *Press Release*, 29/9/2001; BP, *Press Release*, 12/10/2005

¹⁸ Nesibli, N., 'The Independent Azerbaijan's Oil Policy', Lecture at the University of California at Berkeley, 15/4/1998

¹⁹ *Azerbaijan Human Development Report*, UNDP, 2000, pp.31-33

²⁰ *Economic Trends Quarterly Issue: Azerbaijan*, January-March 2001, p. 24, pp.52-53

employment for nearly 70,000 people including 18,500 professional engineers and technicians.²¹ If the families of the people employed by SOCAR are included, the economic impact of energy development in Azerbaijan is obviously immense. Working in the oil industry is a real privilege for anyone in Azerbaijan: SOCAR provides relatively good pay and benefits.²² In addition, the AIOC employs 11,000 Azerbaijani workers and experts, whose salaries range from \$200 to \$1,000 per month, well over the average level of income per head. It is estimated that the ACG project alone is expected to provide 70,000 local people with employment during the lifetime of the Full Field Development by 2024. The Azerbaijani proportion of senior and middle-ranking employees in the AIOC increased from 30 per cent and 70 per cent in 1995 to 70 per cent and 85 per cent in 1998, respectively. In the near future, the proportions of Azerbaijani senior and middle-ranking employees are expected to reach to 90 per cent and 95 per cent respectively, while the proportions of foreign employees in these two positions are to occur as 10 per cent and 15 per cent.²³

Nevertheless, although there seems to be a significant increase in the average nominal monthly wage from \$55 in 2001 to \$94 in 2004, Azerbaijan is still one of the poorest countries in the world.²⁴ Over a million displaced Azerbaijanis have continued to rely heavily on free, but limited, health care, education, transportation and accommodation, provided by the government. Schools and health clinics were also opened for displaced people in various parts of the country, and dozens of scholarships were provided for Azerbaijani students by the AIOC. Capital derived from oil contracts is frequently devoted to easing problems of displaced people. Just in 2004, the Azerbaijani government spent over \$15 million from the oil revenues for financing the resettlement needs of the displaced people while it paid \$18 million for funding its share in the construction of the BTC pipeline.²⁵

There is still much to be done to improve the quality of life in Azerbaijan. Oil revenues will surely continue to play a key role in this. The Soviet oil, petro-chemical, metal and food industries, located in and around Baku, Sumgait, Ali-Bayramli, Ganja, Daskasan, Mingacevir, Mugano-Salyani and the Caspian shores, made Azerbaijan one of the most polluted countries in the world.²⁶ Air pollution and water quality problems, and related diseases of cancer and allergy have caused serious health threats among the society living in those population centres. State Committee on Ecology and Control of Natural Resources Utilisation has worked on the rise of the public awareness on the environmental issues and pressurised oil companies in the country for oil and related

²¹ 'The Oil and Gas Industry of Azerbaijan,' SOCAR, op cit., p.2

²² Salmanov, S., Vice-President of SOCAR, 'Neft ve Sosial-Iqtisadi Inkisaf', *Iqtisadiyyat ve Heyat*, 20/9/2001, p.3

²³ *Azerbaijan*, 20/9/98; *Early Oil Production: Environmental Impact Assessment*, AIOC, Baku, 20/9/1996, pp. 253-258; *Azerbaijan Human Development Report*, UNDP, 1998, p.56 ; *Azeri, Chirag and Gunashli (ACG) Phase 1 and Shah Deniz Stage 1 Development Early Civil Engineering Works Programme: Environmental and Socio-Economic Impact Assessment (ESIA)*, AIOC, October 2001, Chp. 11, pp.15-18; *BP-Azerbaijan Sustainability Report*, 2003, pp.25-26

²⁴ *State Programme on Poverty Reduction and Economic Development (2003-2005)*, Progress Report, Baku 2005, p.178

²⁵ *Ibid.*, p.23

²⁶ 'Azerbaijan Human Development Report', 2000, op cit., pp.39-42; *Azerbaijan Republic: National Environmental Action Plan*, The State Committee on Ecology and Control of Natural Resources Utilisation, Baku, 1998, pp.21-51

pollutions. According to the PSA of the ACG, the AIOC has to comply with laws concerning public health and safety, and the protection of the environment that meet international standards and practices. The AIOC has held conferences open to the public and published reports on the environmental impact of the finished and ongoing works in oil development. Nevertheless, oil revenues and western technology will not be able to solve Azerbaijan's environmental problem alone: 60 per cent of land, 90 per cent of water sources, and 40 per cent of the surface of the Caspian are considered to be zones of environmental disaster. Public education, awareness and the determination of the government are key factors in dealing with existing and future environmental problems.

As a result of the completion of the early oil project, the AIOC began producing 100,000 barrels of oil per day from the Chirag 1 platform and started sending it via the Baku-Novorossiysk and Baku-Supsa pipelines from October 1997 and April 1999 respectively. By August 2001, total early oil output through these two pipelines reached 5.57 and 10 million tones of oil respectively.²⁷ Until the end of 2003, the AIOC spent \$2.4 billion on early oil production and \$2.5 billion on the realisation of the Phase 1 for the development of Azeri oil deposits, and committed a further \$2.3 billion to the following Full Field Development of the ACG project. Phases 2 and 3 of ACG, which are expected to be completed in 2006 and 2008 respectively, will require an additional \$7 billion of investment.²⁸ After the completion of Phase 1, average oil production of Azerbaijan reached to 318 thousands bpd in 2004.²⁹ The total volume of oil production from ACG is expected to be between 800,000 and 1 million barrels per day (40-50 million tonnes per annum) in 2008.³⁰

All profits gained from the oil produced from Chirag 1 were used to refund capital expenses.³¹ Meanwhile, Azerbaijan has received benefits of almost \$ 1 billion from the ACG's PSA, including \$202 million in bonus payments, free associated gas, upgrading of existing SOCAR infrastructure, lease payments, taxes and payments to employment and social funds. For instance, the AIOC spent \$452 million on local goods and services, and paid \$100 million in tax to the Azerbaijani government between 1995 and 2000.³²

Having been aware of the important position of oil projects and the revenues from them, the related PSAs have a privileged position before the law in Azerbaijan. Each of the 22 PSAs is enacted as a law through a presidential decree followed by the Parliament's ratification. The Azerbaijani government has also adopted a flexible and progressive position toward the PSA contractors and their sub-contractors such as immunity from various taxes and waiver of import and customs duties, while most of the other areas for investment of foreign companies are often embroiled by various taxes, bureaucratic confusion and corruption.³³ Similarly, Haydar Aliyev delivered a

²⁷ BP-Azerbaijan, *Metbuat Melumatı*, 27/4/2001; AIOC, *Press Release*, 30/8/2001

²⁸ BP-Amoco, *Press Release*, 31/8/2001; 'BP-Azerbaijan Sustainability Report 2003,' op cit., p.5; BP-Azerbaijan *Sustainability Report 2004*, p.14

²⁹ BP *Statistical Review of World Energy*, June 2005, P.6

³⁰ *Respublika*, 31/08/2001

³¹ 'The Oil and Gas Industry of Azerbaijan,' SOCAR, op cit., p.26

³² AIOC, *Press Release*, 21/9/1999; AIOC, *Press Release*, 3/8/2000; The Speech of David K. Woodward, President of BP-Azerbaijan, at the conference on 'Building Relations in a New Region and Building Agreements and Licences to Operate', Azerbaijan Neft Academy, Baku, 16/10/2001

³³ Horton, S., 'Law Reform in Azerbaijan: Snapshot in a Time of Transition', *Caspian Studies Program Experts Conference Report*, Harvard University, October 1999, pp.69-70

presidential decree in December 1999 establishing the State Oil Fund. According to this decree all profits derived from PSAs were to be put into the Fund, which would have a separate budget and be governed by the President. The main objective of the Fund is to make the allocation of oil revenues for investment in non-oil sectors transparent.³⁴

THE ROLE OF CASPIAN ENERGY RESOURCES IN AZERBAIJAN'S SECURITY STRATEGY

The Elchibey Period: A Strategy Emerges

The development of Caspian energy resources is not just an economic phenomenon but also an important instrument for providing the political and territorial security of Azerbaijan. If the declaration of independence in 1991, membership of international organisations and recognition by the other states are the formal aspects of independence, Azerbaijan's engagement with multinational oil companies and governments in developing its energy resources is the practical aspect of it. Azerbaijani leaderships have tried to use the commercial interests of multinational companies and stronger states to increase Azerbaijan's security. This can be clearly observed in the political behaviour of the Azerbaijan Popular Front (APF) government after coming into power.

Negotiations with western oil companies first took place under the AzSSR (Azerbaijan Soviet Socialist Republic) leadership in 1989, when Gorbachev's reforms in the USSR allowed such actions. Amoco won the bidding in June for exploration of the ACG oil deposits opened in January 1991 to western oil companies. The AzSSR government and Amoco agreed to form a joint venture in which Azerbaijan's share would be 85-88 per cent, while Amoco's would be 12-15 per cent. Amoco would also take over responsibility for preparing the technical and economic details of the agreement and put \$650 million towards developing Azerbaijan's economy. Nevertheless, the AzSSR leadership under the influence of the APF concluded that the consortium would exploit only the Azeri oil deposits of the ACG fields led by Amoco, and should include the Unocal, BP-Statoil, Mc Dermott and Ramco oil companies as well. The APF leadership, which wanted BP and other oil companies to participate to the consortium, considered that Azerbaijan's oil deposits had strategic importance and should be used in the strategic interests of the country. With the participation of the other companies, technical and economical feasibility works were completed in October 1991. According to this, the contract would include a 33-year period, during which Azerbaijan was estimated to get \$33 billion. The consortium would invest \$6 billion for the development of the oil deposits and the agreement would be reassessed at the end of 10 years and then every 5 years period.³⁵

Intensification of the war over the NK region and its subsequent impact on the developments within the domestic political arena allowed to the rise of the APF, which later in June 1992 came into power. Under the leadership of Elchibey, the APF

³⁴ 'Azerbaycan Respublikasi Dövlət Neft Fondunun Fealiyyətinin Təmin Edilməsi ilə Bağlı Tədbirlər Haqqında Azərbaycan Respublikası Prezidentinin Fərmanı,' *İqtisadiyyat və Hayat*, No. 6-9, 2001, p.43; Interview with İlham Aliyev, Vice-President of SOCAR, *Dirçelis*, No. 21-22, Noyabr-Decabr 1999, p.22

³⁵ Fətullayev, E., 'Neft Müqaviləsi Etrafında Danışıqlar Prosesinin Tarixi-Siyasi Tehlili,' *Qanun*, No.2, Fevral 1996, p.30; *Azadlıq*, 24/4/1992

government did not stop talks with western oil companies; on the contrary, it tried to negotiate contracts not only for the ACG fields but also for other deposits as well. Contracts to develop the Chirag and Shahdeniz deposits were negotiated with BP-Statoil, the Gunashli with Pennzoil, Oil Rocks with Ramco and the Azeri field with Amoco. In May 1993, a memorandum was signed on the development of the ACG fields, which incorporated into one consortium including SOCAR (30 per cent), BP-Statoil (25.69 per cent), Amoco (17.01 per cent), Pennzoil-Ramco (11.9 per cent), Unocal (11.2 per cent), Mc Dermott (2.45 per cent) and TPAO (1.75 per cent). The APF government also signed protocols with TPAO from Turkey, Delta from Saudi Arabia and Unocal from the US on oil and gas exploration rights in various Azerbaijani parts of the Caspian.³⁶ The government's policy on the oil contracts was clear in that it wanted to bring in badly needed foreign capital to fund the recovery of the economic and social structure of the country. According to Bagirov, chairman of the SOCAR during the APF government, "We need to attract much needed foreign capital to the country. We have no technical and financial capability for the development of these oil deposits. If these western companies began working in Azerbaijan's energy development, this would mean there is stability in our country and then many other companies in many different areas would choose to come here to do business."³⁷

In the government's oil negotiations, the delimitation of the revenues to be received from the development of the ACG would be decided within the final contract to be signed later. Bagirov assured that, regardless of the investment shares of the companies above, Azerbaijan would receive more revenue than the oil companies, which estimated the development of the ACG deposits to be worth \$8-10 billion.³⁸ The APF government signed 6 documents in May with the oil companies for the establishment of joint committees, and a declaration followed in June for the joint exploitation of the ACG fields. The final agreement on the development of the ACG with the oil companies was planned to be signed in London in September. For Bagirov, according to the proposed agreement, as well as financial advantages to be provided for SOCAR to realise its 30 per cent share, any company in the consortium was not able to sell its share to another company without the endorsement of SOCAR. Each company would pay \$3 million to the government as a bonus for every percentage of their share in the consortium. A representative of SOCAR would head the joint committee to be established between the consortium and SOCAR.³⁹

From a strategic political and security point of view, the APF leadership believed that, signing a contract with the western consortium was of great importance because Azerbaijan's independence hinged upon getting rid of Russian political and economic interests as quickly as possible.⁴⁰ As Russia was seen primarily as responsible for the war and for the advance of Armenian forces in the NK region, the APF government saw that western states, with pressure from their oil companies in Azerbaijan, would put pressure on both the Russian and Armenian governments. In fact, western oil companies began to be seen by the Azerbaijani media as Azerbaijan's lobbying forces in the West against the Armenian Diaspora.⁴¹

³⁶ Bagirov, Sabit, 'Neft Danisigllari: Avgust 1992-Iyun 1993', *Azadliq*, 4/6/1994

³⁷ Interview with Sabit Bagirov, president of SOCAR, Azerbaijan, 23/9/1992

³⁸ Interview with Sabit Bagirov, Former President of SOCAR, *Azerbaijan*, 12/6/1993

³⁹ Cited in Nesibli, N., 'Azerbaijanin Geopolitikasi ve Neft', op cit., pp.16-17

⁴⁰ Interview with Sabit Bagirov, *Azadliq*, 10/8/1993; Interview with Sabit Bagirov, Baku, 3/10/2001

⁴¹ *Azadliq*, 23/2/1993; *Azerbaijan*, 1/5/1993

In line with the above idea adopted by the APF government, in contrast to the hesitation of the Kazakh and Turkmen leaders, Elchibey followed an energy policy that would not have been possible without Turkey's participation in the consortium. Particularly, Azerbaijan was going to sign a formal agreement on the development of the ACG oil deposits with the companies in September.⁴² When the APF government was removed from power in June in 1993, the development of oil and gas resources in Azerbaijan became increasingly linked to the security of the country. For many, the most important reason for toppling the APF government was the exclusion of Russia and Russian companies from the oil negotiations. This aspect can be seen clearly in an interview with Suret Huseyinov, who, after deposing the Elchibey government, became Prime Minister in Azerbaijan. He said this to the Russian *Nezavisimaya Gazeta* on September 22, 1994, "as far as the oil issue is concerned, the agreement should be made with Russia because there has been an economic relations with it for a long period of time. Azerbaijan and Russia should strengthen economic relations on the related matter and there should not be a reverse on this issue. Azerbaijan should have signed an agreement first with our neighbour and brother Russia, and then the others would have been considered."⁴³ The link between security of Azerbaijan and the fate of the oil contracts seems to be valid if one considers the major difference between the two contracts during the APF and Haydar Aliyev governments.

Haydar Aliyev, Energy and the Security of Azerbaijan

Formerly on the sidelines, Russia became one of the most important parties in energy negotiations when Haydar Aliyev came to power after the APF government was deposed. Accordingly, the oil contracts still to be signed became one of the most, perhaps the most, important components in the security of Azerbaijan and thereby Haydar Aliyev's political manoeuvres towards international audiences.

As soon as Haydar Aliyev became acting President, he ceased all proposed oil contracts conducted by the APF government. Haydar Aliyev's explanation of the suspension of the contracts was that the proposed oil deals were against the national interests of Azerbaijan. In the state-owned newspapers, central figures in the new government began spreading the news that if the oil contracts negotiated by the APF government had been signed, Azerbaijan would have lost no less than \$35 billion.⁴⁴ In his meeting with the representatives of Amoco, Haydar Aliyev pointed out that they did not agree on previously negotiated oil contracts. He explained that they could hold new negotiations only after newly appointed Azerbaijani experts had concluded their review of previous contracts. At the meeting, Haydar Aliyev also reminded them that the new contracts should respond to Azerbaijan's economic and political interests, particularly to the developments of the relationships between the US and Azerbaijan.⁴⁵

Before and after the contract of the century was signed on 20 September 1994, Haydar Aliyev used oil as a balancing tool against the military and political challenges

⁴² Sariibrahimoglu, L., *Kurt Kapanin da Kisir Siyaset*, (Ankara: Imge Kitabevi, 1997), pp.25-26; Interview with Sabit Bagirov, *Azadliq*, 10/8/1993, op cit.; Bagirov, Sabit, 'Neft Danisqlari: Avgust 1992-Iyun 1993', op cit.

⁴³ Interview with Suret Huseyinov, the Azerbaijani Prime Minister, 22/9/1994, quoted from Aslan, Y., *Ucuncu Roma'nin Jeopolitik Arzulari*, (Ankara: Poyraz Ofset, 1996), pp.143-144

⁴⁴ *Azerbaijan*, 13/7/1993

⁴⁵ *Azerbaijan*, 1/2/1994

directed against Azerbaijan. Haydar Aliyev might have thought that before securing a cease-fire on the NK war, Azerbaijan would have not been able to sign an oil contract that could satisfy all parties wanting to join. Most importantly, while the NK war was continuing, unsatisfied Russia or any other state in the region in the oil deal, may easily have tried to topple Haydar Aliyev himself as it had done to Elchibey. Azerbaijan's participation to the Commonwealth of Independent States (CIS), Russian-led Collective Security Organisation, and Haydar Aliyev's manoeuvring over the Russian demands of the deployment of its military forces in the country brought cease-fire on the NK war in May 1994. On the oil contracts, Haydar Aliyev demanded more profit shares than that of the APF governments' proposed contract, and appointed Marat Manafov, a Slovakian businessman, to restart negotiations for a new deal. The negotiation for new contract was later given to the SOCAR when Ilham Aliyev, President's son, was appointed as the first deputy chairman of it in 1994. During this initial stage, Haydar Aliyev, after coming into power, gave first priority to meeting the Russians and bringing them into the new oil development projects. On November 19-20, 1993, Yuri Shafranik (Energy Minister of Russia) and Alekperov (chairman of LUKoil) visited to Baku and insisted that they wanted no less than 20 per cent of the development of ACG oil deposits. The Russian side also requested the coming consortium be included only 2 oil fields, but not all 3 deposits, and that future pipelines for oil transportation from Azerbaijan should run via the Russian Federation.⁴⁶ Finally on September 20, 1994, first contract, the so called 'the Contract of Century,' on the development of ACG oil fields was signed after long 4 rounds of negotiations with oil companies in Baku, Istanbul and Houston since March. This new contract differed from the one previously proposed by APF government in that Heydar Aliyev government had to take into account the geopolitical realities in a different way. Most important aspect of the new contract was that Russian oil company LUKoil joined the consortium with a 10 per cent share while the proportions of the other oil companies remained more or less the same as agreed during the APF government. LUKoil's share in the new contract was, in fact, allotted from the 30 per cent portion of SOCAR. In addition, from SOCAR's share Haydar Aliyev gave 5 per cent to Iran and increased Turkey's share from 1.75 to 6.75 per cent.⁴⁷ Iran's share in the consortium was later taken back and given to Exxon in April 1995 as the US government was opposed to American companies being in the same oil consortium.⁴⁸ However, Haydar Aliyev, who subsequently gave a 10 per cent share to the National Iranian Oil Company (NIOC) in the Shahdeniz Consortium in which there was no American oil company, could not ignore Iran, as one of the three important geopolitical actors in the region. LUKoil, TPAO and NIOC have later also got various shares various other oil consortiums in Azerbaijan.

Having signed 'the Contract of the Century', Haydar Aliyev had successfully played the Russian Energy Ministry and LUKoil against the Ministry of Foreign Affairs and the Military in Russia. While Shafranik participated in the signing ceremony of 'the Contract of Century' with the support of the Russian Prime Minister, Chernomyrdin (a political figure closer to LUKoil), the Russian Foreign Ministry announced that it would not recognise the deal on the basis that the status of the Caspian was not yet resolved.

⁴⁶ Nesibli, N., 'Azerbaycan Geopolitikasi ve Neft', op cit., p.17; Gul, A. ve Gul, A. Y., *Avrasya Boru Hatları ve Turkiye*, (Istanbul: Baglam, 1995), pp.45-46

⁴⁷ *Azerbaycan*, 4/4/1995

⁴⁸ *Azadliq*, 4/4/1995

Referring to the differences within Russian internal politics towards Azerbaijan, Haydar Aliyev stressed that Shafranik and Chernomyrdin supported the contract, and yet some forces in Russia were still trying to prevent them from cooperating.⁴⁹ Even some Russian newspapers wrote that the participation of LUKoil in 'the Contract of the Century' should be accepted as a success because, until recently, during the era of the APF government, there was the danger of Russia's oil companies being totally excluded from the former Soviet territories. Even the Russian *Kommersant* Daily newspaper wrote that Azerbaijan, after Suret Huseynov's failed attempt to remove Haydar Aliyev from power in October 1994, was no longer under Russia's influence, and now on there was no possibility of Russia deploying its military forces in Azerbaijan.⁵⁰ That is why Haydar Aliyev had often referred to LUKoil and other Russian companies doing business in the country as the pillars of cooperation between Azerbaijan and Russia.⁵¹

It was true that, after 'the Contract of Century', Russia still wanted to deploy its military forces in Azerbaijan, but the Haydar Aliyev government always avoided the prospect of such a development. Indeed, the dictum of 'oil contracts for security' has further gained impetus among the political leadership and opposition in Azerbaijan. The Azerbaijani leadership stressed during every official visit to western capitals that Armenia, Russia and Iran had threatened political stability in Azerbaijan, endangering billions of dollars of investment and the future profits of the oil companies. During his first official visit to the US in September 1997, Haydar Aliyev signed oil agreements with various American companies worth \$7.5 billion. In his meetings with President Clinton, 40 Congressmen and a number of businessmen, Haydar Aliyev urged them to be sensitive towards the territorial integrity of his country, Armenian aggression, Russian pressure and the American ban on governmental aid with Section 907 to Azerbaijan. Yet, the only response of the American governments and oil companies to the Haydar Aliyev's appeal had been no more than reiterating their optimism that the US Congress would abolish the section 907.⁵² For instance, one American oil company executive said to the New York Times newspaper that Section 907 had been interfering with plans to expand oil business in Azerbaijan. However, the same individual also stressed that the company did not want to get involved in the conflict between Azerbaijan and Armenia.⁵³ The Clinton and later the Bush administrations had argued on a number of occasions that Section 907 hindered American influence on the post-Soviet transition of Azerbaijan and their economic interests there. The State Department had been concerned that American hesitation to abolish Section 907 pushed the Azerbaijani leadership in signing a number of lucrative energy contracts, such as Shahdeniz, with European, Japanese, Russian, Iranian and Saudi oil companies, leaving the American companies either not involved, or with small shares.⁵⁴ In fact, even if US companies wanted all the contracts for themselves, it would be impossible for Azerbaijan to ignore

⁴⁹ *Azerbaijan*, 8/6/1995, p.1; *Azadliq*, 2/11/1993

⁵⁰ *Kommersant Daily*, 8/10/1994, in Azerbaijani in *Azerbaijan*, 14/10/1994

⁵¹ *Azerbaijan*, 3/10/1999

⁵² *Azadliq*, 16/8/1997; *Azerbaijan*, 2/9/1997; *Azerbaijan*, 16/9/1997

⁵³ Lacey, M., 'Azerbaijan Lobbies Amid Mix of Oil, Politics and a Congressional Blacklist', *New York Times*, 2/3/2000

⁵⁴ Acker, B.A and Ellison, H.J., 'Azerbaijan: US Policy Options', *The National Bureau of Asian Research Briefing*, June 1997, www.nbr.org/publications/briefing/ellison97/index.html, 2/13/2001; Ros, S., 'ABS Xezer Neftini Oz Ixtiyarında Saxlamaq Ucun Hereket Etmelidir', *Washington Post*, 1/2/2001, in Azerbaijani in *Azerbaijan*, 6/2/2001, p.1

Russia and Iran because of their proximity to the country and the overall geopolitical and many other characteristics of the region.

As far as the Azerbaijani government's efforts to form a lobbying group through various oil companies are concerned, one may ask to what extent the oil contracts have contributed to the security of Azerbaijan since 1994. A specific answer to this question cannot be given. For Bagirov, oil companies from both the US and Russia have contributed limited support for Azerbaijan against the Armenian lobbies in those countries, and one could not expect more than this at this stage as the bigger stakes were not on the table yet.⁵⁵ For others, oil business has contributed to the security of Azerbaijan because oil contracts have curbed the Russian insistence on deploying its troops in the country, and made Armenia as well as Iran much more cautious in their policies towards Azerbaijan, in order not to endanger their own and other states' economic and political interests. However, one can also say that oil contracts failed to contribute to Azerbaijan's security because the recovery of 20 per cent of the country's territory from Armenia and the return of the displaced Azerbaijanis to their lands have not been accomplished. The oil contracts have, in fact, only helped to maintain the status quo established in 1994, but not yet made a huge contribution to the security of Azerbaijan. Even when the US Congress finally suspended the Section 907 in 2002, this happened not because the American side finally began listening Azerbaijan's urge on the influence of the NK issue on the security of the pipelines and energy projects in the region, but because Azerbaijan opened its airspace for the use of the American military to combat against 'international terrorism' in Afghanistan and elsewhere. The Azerbaijani leadership has continuously asked for more security assurances from those states whose oil companies have engaged in oil business in the country, primarily from the US, of support for Azerbaijan's independence. Otherwise, the gains that Azerbaijan and oil companies had made since 1994 could vanish anytime if the cease-fire was broken with Armenia for any reason. Oil companies in Azerbaijan have nonetheless kept themselves away from the security problems of Azerbaijan. They seem to have not interested in influencing their powerful governments and lawmakers to resolve the NK dispute between Azerbaijan and Armenia in a just way, and appear to have satisfied only with a certain level of internal stability in the country. Indeed, such expectation from Azerbaijan on the NK dispute can have little chance, if none at all, for success as far as the example of the US foreign policy towards the Palestinian issue and American oil companies' stakes in Saudi oil is considered.

Energy Development as an Internal Political Tool in Azerbaijan?

Haydar Aliyev until his death at the end of 2003 had stayed in power through distortions and widespread frauds in Parliamentary and Presidential elections since he captured power from the democratically elected APF government in 1993. Even his death, which followed the succession of his son, Ilham, as the new President, has not removed his influence on the ever-continuing energy development and stability issues of Azerbaijan. The oil ventures have been controlled by narrow elite around whom Haydar Aliyev and Ilham Aliyev seem to have kept themselves and his supporters in power at the expense of political stability in Azerbaijan.

⁵⁵ Interview with Sabit Bagirov, 3/10/2001, op cit.

Azerbaijan was and still has been classified as one of the most corrupt countries in the world. On the other hand, however, exclusive laws, decrees, and the control of a small professional elite over the energy contracts outside the complex, and corrupt, state bureaucracy have enabled Azerbaijan to make swift progress on energy policy. Regardless of the way Haydar Aliyev came to power, his Presidency with the help of his close associates, such as Ilham Aliyev and Natiq Aliyev, the Head of SOCAR, has provided a stable environment for the negotiations and the progress of the contracts. In fact, there is no lack of accusations that Haydar Aliyev had used oil revenues to maintain and to promote further the financial and political ambitions of the 'family' and ruling elite.⁵⁶ It is claimed that many state employees at the SOCAR were forced to register as members of the President's NAP (New Azerbaijan Party), otherwise they were threatened with losing their job.⁵⁷ Moreover, Zerkalo, an independent newspaper, reported that after 17 contracts, the Azerbaijani government should have received \$695 million of bonuses according to the figures specified in the contracts ratified by the Azerbaijani Parliament. However, Rustamov, the chairman of the NBA (National Bank of Azerbaijan), said that the total amount of bonuses received from the oil companies was \$634 million. Zerkalo also claimed that the \$22 million bonuses of the \$97 million paid by Exxon-Mobil for the contracts of the Zafar and Mahal oil fields were also missing.⁵⁸ In the same newspaper later in February 2001, Arif claimed that over 800,000 barrels of oil, worth \$166 million, went missing in Azerbaijan in 2000. He assumed that the stolen oil was either refined at various illegal small refineries in the country and sold under the counter at filling stations or smuggled out of Azerbaijan. For him, even if the government were not responsible for this, it was still responsible for turning a blind eye to such a scale of theft for the political and economic benefits of the ruling elite.⁵⁹ On the same issue of illegal export of oil from Azerbaijan, Mammadov, the leader of the NIPA (National Independence Party of Azerbaijan) stated that the amount of oil stolen from Azerbaijan reached 1.5 million tonnes per year, and accused top officials, such as Natiq Aliyev and Ilham Aliyev, of being part of the illegal action.⁶⁰ Similarly, although oil prices were about \$25 per barrel in 2000, which was higher than the government's prediction of \$17, it was argued that private individuals siphoned off the additional income.⁶¹

For those who are against Haydar Aliyev, the amount of bribes allegedly given to the President's family has varied from billions to tens of millions of dollars. The claims of corruption in the oil sector made against the government seem to be based on the general belief that as there is corruption all over Azerbaijan, so is in the oil sector. Then, it is not difficult for the Opposition to claim that the political leadership in Azerbaijan gave the national resources of the country to Georgia in the tariff negotiations for BTC

⁵⁶ Interview with Isa Gambar, Baku, 17/10/2001; Interview with Ali Kerimli, Baku, 20/10/2001; Interview with Serdar Jalaloglu, Baku, 6/10/2001

⁵⁷ *Hurriyet* (Azerbaijan), 23-24/10/2001

⁵⁸ *Zerkalo*, 2/12/2000, in English in 'Azeri Paper Raises Issue of Missing Bonuses from Foreign Oil Firms', *BBC Monitoring Service*, 4/12/2000

⁵⁹ Arif, T, 'In 2000, 166 Million Dollars' Worth of Fuel was Stolen', *Zerkalo*, 17/2/2001, in English in *Azerbaijan News Distribution List*, 26/2/2001

⁶⁰ *Yeni Musavat*, 3/11/2001

⁶¹ Masimov, A., 'Why Does Not the People Get Profit from Oil?', Azerbaijan National Democracy Foundation (ANDF), *Azerbaijan Democracy Monitor*, No.10 (23), October 2000; Bayramov, V., '112 Milyon Dollarlıq Sir', *Azadlıq*, 12/9/2000

and BTE. Similarly, from the Opposition's point of view, although the Oil Fund was established by the government to show its transparency in spending the oil revenues, such an objective has been void from the start because the political leadership itself has been established, and functions, on the basis of autocratic principles and ambiguity.⁶²

Whether the ruling elite has used oil revenues for their own individual interests or not, one thing is clear that energy development and pipeline issues have been Haydar Aliyev's and his close affiliates' biggest political assets in justifying and maintaining their power in Azerbaijan. After Haydar Aliyev came to power, the proportion of people in government offices who had regional and family ties to the President increased. The President's close and distant relatives have occupied a number of key positions in economic, political and police departments in the country. For instance, Haydar Aliyev's son-in-law, Mahmud Mammadquliyev, was made first Deputy Foreign Minister and later Azerbaijan's Ambassador to London, and then back to his previous position. Heydar Babayev, Ilham Aliyev's daughter's father-in-law, has been the chairman of the State Committee for Securities.⁶³ Haydar Aliyev placed his son, Ilham, in the post of vice-Presidency of the SOCAR at the age of 38, who was elected later as a deputy in the ruling New Azerbaijan Party in the Parliamentary election in 2000. Ilham Aliyev, who had also been the chairman of the National Olympic Committee and the head of the Azerbaijani delegation to the Council of Europe, had been kept as the vice-President of the SOCAR so as to enable him to develop his ability to run the state, when the ageing President passed away. Since the President's heart problem became worse in 1999, many opposition and ruling party members saw his son as a possible replacement. Even though Ilham Aliyev had always remained silent on the issue of succession, Rauf Huseynov, one of the Presidential advisers, was reported to have admitted that the President's son had already been chosen to lead the country when the time came.⁶⁴ Having given various examples from the US and India, some pro-government figures already strongly believed that democracy was compatible with nepotism, so there was no reason for Ilham Aliyev not to take his father's place.⁶⁵ Obviously, the figures, who made such comparisons, avoided discussing the fairness and openness of the election process in Azerbaijan. When asked, these pro-government figures tended to explain the election frauds and high level of corruption as the results of the transition period.

According to some observers, if the Presidential election in Azerbaijan had been held fairly, Haydar Aliyev would have genuinely taken between 55 and 65 per cent of the votes, which is enough for his legitimacy. Even so, because this level of the vote was not enough to satisfy his ego, the presidential elections were a fix, in which he was declared to have taken 98 per cent and 76 per cent of the votes in 1993 and 1998 respectively. Thus, the true level of the popularity of the presidential

⁶² *Azadliq*, 29/9/2001; *Yeni Musavat*, 2/10/2001; *Azadliq*, 31/10/2000

⁶³ *Hürriyet*, (Azerbaijan), 2002, in 'Azeri Paper Publishes List of President's High Ranking Relatives,' BBC Monitoring Service, July 10, 2002; also see, Arslan, Y., 'Azerbaycan Bilmecesi: Petrol, Darbeler ve Gerçekler', *Avrasya Dosyası*, Cilt.1, No.4, Kış 1994/95, p.212

⁶⁴ Interview with Ilham Aliyev, *Qanun*, 1.Kitab, Bakı, 1999, p.31; Interview with Ilham Aliyev, *Dirçelis*, No. 3(25), Mart 2000, pp.23-24; Stern, D., 'Azerbaijan: Elections Confuse a Fuzzy Picture', *Financial Times*, 22/11/2000

⁶⁵ Ivanov, A., 'Demokratiya İrsi Ola Bilermi?' *Nezavisimaya Gazeta*, 5/10/2000, in Azerbaijani in *Dirçelis*, No. 10(32), Oktyabr 2000, pp.17-24; Interview with Zahit Garalov, Deputy from the New Azerbaijan Party at the Parliament and is in charge of regional issues, Bakı, 15/10/2001; Interview with Sahlar Aleskerov, Deputy from New Azerbaijan Party at the Parliament, Bakı, 23/9/2001

candidates in Azerbaijan has never been known under such election fixations.⁶⁶ In order to keep Aliyev family in power, just before his feeble health suffered a relapse, Haydar Aliyev made an extraordinary political manoeuvre in June 2002 before the eyes of internal and international audiences. He came up with the idea of putting the transfer of Presidential authority to the Prime Minister appointed by the President on referendum in case he relinquished the power before his term ended or could not accomplish his authority. Just before the referendum, Haydar Aliyev placed Ilham Aliyev in the post of Prime Minister at the beginning of August. In line with this idea, the referendum in August, which also included 39 Constitutional amendments that were no doubt to embellish the real intention of Haydar Aliyev, was declared as approved by the people with 96 per cent.⁶⁷ In the previous constitution, the Chairman of the Parliament had been to take over the Presidential power if the President was no longer able to do it, but now same power passed to Prime Minister. As predicted, since the dynastic transition of power from father to son was completed in August, Azerbaijan has witnessed two elections of the Presidency and Parliament in October 2003 and November 2005, respectively. While the former led Ilham Aliyev to become the new President, the latter allowed Aliyev's NAP to maintain its overwhelming majority, except a few seats to the Opposition, in the Parliament. In both elections, according to the international observers, similar patterns of marring and fraud by the state authorities to those in the 1990s were observed.⁶⁸

Regardless of the complains expressed by the international observers and Azerbaijani Opposition on the recent election processes and elections themselves, Russia, Turkey and the US as major geopolitical actors in the region were quick to announce their approval of the legitimacy of Ilham Aliyev and Parliamentary election in Azerbaijan.⁶⁹ These international approvals of Aliyev family may be considered as one aspect of the link between energy development issues and political stability in Azerbaijan. One may say that Russia, Turkey and US recognised the legitimacy of Haydar Aliyev and later Ilham Aliyev because they did not endanger their geopolitical and economic stakes in the Caucasus. This is true for a certain extent, but external approval is not the primary source of legitimacy of the Aliyev regime in Azerbaijan. Russia, US and Turkey, as seen in the case of Georgia where they have as much conflicting interests as they have in Azerbaijan, had to recognise Saakashvili whether they like him or not. In Azerbaijan, major argument put forward by Haydar Aliyev and his son is that if they did not rule the country, all successes gained from the oil and pipeline projects would vanish in the hands of the Opposition. Therefore, the factor of energy development with its financial benefits to the ruling elite and psychological influence over the people has been a major internal tool, but not an international one, to maintain power in Azerbaijan by the Aliyev regime.

⁶⁶ Goltz, Thomas, 'The Question of Succession in Azerbaijan: Is the Aliyev Era (Almost) Over?', *Caspian studies Program Experts Conference Report*, Harvard University, October 1999, p.39

⁶⁷ *Democratic Congress Bulletin*, N19 (64) July 9, 2002; Giragisian, R., 'A New Setback for Azerbaijan's Succession Plan,' *Azerbaijan Daily Digest*, September 25, 2002; 'Guide to the Azeri Presidential Election 15 October 2003,' *BBC Monitoring Research*, October 2, 2003

⁶⁸ 'OSCE Human Rights Head Deplores Wave of Arrests in Azerbaijan,' *OSCE Press Release*, October 20, 2003; Country Summary: Azerbaijan, *Human Rights Watch*, January 2005

⁶⁹ Torbakov, I., 'Russia Backs Dynastic Political Succession Scenario in Azerbaijan,' *Eurasia Insight*, 7/8/2003; *Eurasia Insight*, 17/10/2003; *Eurasia Insight*, 16/6/2004

CONCLUSION

Post-independence energy development of Azerbaijan has been the primary source that the Azerbaijani governments have tried to use to improve security and stability of the country. Nevertheless, while development of the energy sources of the country has only maintained the regional status quo established in 1994 on the external security matters, it has failed to boost much expected socio-economic and political transformation in the country. Even especially on the issues of domestic political participation and stability, energy development seems to have been a curse rather than a cure for Azerbaijan.

Similar to those of the newly independent states in the former Soviet area, Azerbaijan inherited a collapse economic and social structure. It was no doubt logical for the Azerbaijani governments to use the country's abundant oil and gas resources to ease the socio-economic heritage of the Soviet past. Indeed certain level of success has been achieved on this matter. Despite long delay on the development of energy resources owing to the geopolitical squabbling that caused to power change in Baku in 1993, Azerbaijan has attracted considerable amount of foreign capital by the end of 2005. This capital, though full flow of oil and gas revenues are expected to come to the country after the completion of ACG projects in 2008, has continuously used to improve the living conditions of the people and especially of the displaced people. Current level of achievement in the improvement of living conditions is not satisfactory enough as there are still huge amount of problems in the country, such as corruption, education, environmental pollution, lingering over the Azerbaijani people. It is particularly the deep corruption that without removing this illness, which haunts all spheres of life in Azerbaijan, there will never be a socio-economic transformation no matter how much revenue the country gets from energy development.

Perhaps the biggest, though limited, benefit of the energy development for Azerbaijan is on the regional security issues. The NK issue with its regional geopolitical dimension has no doubt sat on the top of the list of the security problems of Azerbaijan. The APF government under the leadership of Elchibey first tried to exclude Russia from the oil contracts as Moscow was seen the primary force behind the Armenian aggression against Azerbaijan. For the APF government, as the country was on the brink of collapse due to the war in the NK region, energy resources should have been the main assets to reverse the then worsening security situation. It was this exclusion of Russia on the oil projects, as well as Moscow's particular dislike of the APF and its principles, that led to the fall of the Elchibey government. Haydar Aliyev, a guileful political figure within the top layers of the late Soviet state apparatus, had indeed followed the footsteps of Elchibey on the strategic security value of the energy projects with one important difference. For Haydar Aliyev, had Russia remained unsatisfied, there would have been no end in the war over the NK region with Armenia. Nor would there have been any development of energy recourses, let alone to get economic benefit from them. It was this fact that Haydar Aliyev first met with the Russian government officials and oil companies, and concurrently sought a cease-fire with Armenia under the auspices of Russia. Having attracted both the Russian and western oil companies to the energy projects, Haydar Aliyev had managed to keep Russia away from deploying its military forces in the forms of either peace-keeping or military bases in the country. This can be considered as the only success that Haydar Aliyev had accomplished on the regional security impasse of Azerbaijan. Despite

Russia's participation to the energy projects in Azerbaijan, it has continued to support Armenia and the NK Armenians by supplying arms and political patronage.

Haydar Aliyev expected that the US and other western states would help Azerbaijan to persuade Armenia and Russia to end the occupation of the Azerbaijani territories by the Armenians. However, neither oil companies nor their governments have seriously interested in resolving the NK dispute between Azerbaijan and Armenia. While the US government has tended to resolve the problem, it has not taken into account who is the victim and who is the villain in the conflict at all. American oil companies, and others, have looked for a relative domestic stability in Azerbaijan as a necessary condition to do business there. Hence, Haydar Aliyev, who had always argued that oil development and pipelines in the region would bring peace, security, prosperity and democracy to the country, could not succeed in reversing the outcomes of the defeat in the NK war. Without providing Azerbaijan with real territorial and societal security, all of which have been severely weakened by the war with Armenia over the NK region, there could not be talked about economic development and prosperity in the country.

Instead of providing stability and boosting democratic development further, the dictum of 'energy projects for security,' and the only protector and provider of this as Aliyev family, appears to have been one of the main causes of instability in Azerbaijan. By using the above aphorism, Haydar Aliyev and his close affiliates tell and act in the way that they are the only eligible and legitimate force in the country. They seem to have convinced themselves that everything belongs to the country is in fact at their own disposal as no other authority is allowed to check them. Then it can be argued that such a political understanding indoctrinated by Haydar Aliyev seems to have led to the formation of not only a complacent ruling elite unwilling to prevent deep corruption, but also a divided political society liable to endure ever-lasting turmoil in Azerbaijan.