

The contract of the century and its long term implications on the development of Azerbaijan

In the oil industry, Azerbaijan is known as one of the ancient places where use of oil goes back into the centuries. In the mid-19th century, once production of oil reached industrial scale, Azerbaijan became number one oil producer, providing half of the total global oil produced. Since, 1870s Azerbaijan has enjoyed the first oil boom, which attracted foreign investments and skilled labor from around the globe. During the Second World War 75% of oil produced in USSR was coming from Azerbaijan. Nazi Germany was aiming at Baku during the invasion of the Soviet Union, while the British army was planning to destroy Baku's oil fields by massive air bombing if German troops came close to Baku. Azerbaijan's contribution in terms of oil supplies played pivotal role in victory over Nazi Germany.

Azerbaijan has been a pioneer in the oil industry, and many technology advances that we see nowadays were invented and started to operate on industrial scale in Azerbaijan. For instance, first oil tanker found its use in Azerbaijan in the Caspian Sea; first pipeline from Caspian Sea to the Black Sea that took hydrocarbons to the world markets also was built at the turn of the last century; and perhaps the most advanced achievement in the oil and gas industry is the first offshore oil production facility in the Caspian Sea in 1949, which has opened a totally new horizon for the global oil and gas production.

This short excursion into the history shows that Azerbaijan has been playing a fundamental role in development of the world oil and gas industry. Therefore, once the Azerbaijan gained its independence in 1991, there was a lot of interest from the outside of the country to its oil and gas resources. Some called Azerbaijan as a new Kuwait, and envisioned a great future and prosperity for the country.

Unfortunately, the breakup of the Soviet Union has been painful experience for Azerbaijan as a country, and its people in particular. After the collapse of the Soviet Union Azerbaijan found itself at war with Armenia. Iranian intelligence services were infiltrating the country instigating separatist movements in south of the country. North of the country faced some troubles as well, as nationalism was high on the agenda. For young and independent state, which was being torn apart due to Armenian aggression and influx of refugees from Armenia and internally displaced people (IDP), Azerbaijan's economy was in the free fall. Middle class was suddenly disappearing, savings in very short period of time devalued due to the inflation of more than 1000% a year. Country's GDP during the first few years of independence reduced by half. Suddenly, the country which was always considered to be rich and prosperous part of the Soviet Union, found majority of its population leaving below the poverty line, and every seventh person in the country was either a refugee from Armenia or an IDP.

During early years of independence, achieving political stability was extremely difficult, as state institutions and political system were simply paralyzed, and public trust was absent. Azerbaijan had a clear threat of disappearing as a country on the world map, or becoming a failed state.

In these political, economic and social conditions, it was extremely difficult to attract foreign investors to bet money on exploration and development of oil and gas resources on the shores of the Caspian Sea. Besides, one should not forget Russia, which was extremely nervous to any foreign involvement in the region, as Russians still considered CIS countries as area of Russian sphere of influence.

In this situation, one should give a credit to late President Heydar Aliyev, who managed to successfully stabilized the country, call for ceasefire and attract foreign investors into the region. Stabilizing political and economic situation at that time was a key objective. Politically situation was very fragile, the country have been a leader in number of refugees per capita in the world, majority of people lived below the poverty line, and there was no sense of unity between the political parties either. At the same time everyday scores of Azerbaijani citizens were dying in Karabakh, and surrounding areas as a result of a war. Economically, country was in steep decline and inflation was shooting over the roof. It was absolutely important

to centralize power and stabilize country both politically and economically. Also, conflict with Armenia had to be stabilized as well, as it was a major point of uncertainty for foreign investors.

President Heydar Aliyev managed to achieve results in short period of time, which obviously provided some confidence to the investors to come to the country and explore local natural resources. He quite quickly realized that only attracting foreign capital could help country to recover from such apocalyptic crisis such as collapse of the Soviet Union and war with Armenia.

The first major milestone in Heydar Aliyev's policy that became a historical moment for the whole country and the region is when in September 1994 Azerbaijan reached agreement with oil majors and signed a contract which then was called "Contract of the Century" due to its economic and geopolitical importance¹. The contract covered development of three major fields Azeri, Chirag and deepwater part of Guneshli. Accidentally or not, but consortium was carefully structured of oil companies that represented countries that had direct interest in Azerbaijan (US, Russia, UK, and Turkey are the main ones that is worth to mention), in a way providing an opportunity for the interested powers to take part in the development of local resources. The operatorship was given to Amoco, before it was taken over by BP in 1998.

In 1997 Azerbaijan has started to receive first oil from the Contract of the Century, and if in 1995 total oil production went as low as 9.2 mln tons, then in 2010 oil production reached 51 mln. tons².

Heydar Aliyev had a pivotal role in securing "The Contract of the Century", which had important implications on Azerbaijan and the region as a whole in the years to come. One could distinguish the following important changes:

1. At the time of the negotiations with oil majors, Azerbaijan was almost standing on its knees and it was very difficult to stabilize the country in short, medium and long term. Azerbaijan was little known to the world and thanks to the Armenian lobby in the US and Europe was

¹ "The Visions of Azerbaijan", September–October 2010.

² The State Statistical Committee of the Republic of Azerbaijan – Oil Extraction, http://www.stat.gov.az/source/balance_fuel/indexen.php.

largely demonized as an aggressor and violent state. Signature of the major oil deal has attracted attention of international media, private businesses and global policy makers to the country. Azerbaijan had finally an opportunity to stand up to the world and communicate its own interpretation of events that were taking place in Karabakh and surrounding areas.

2. “The Contract of the century” led to many other production sharing agreements for other offshore and onshore fields. Although, many of them had disappointing exploration results, still one cannot ignore number of deals and investments that have been attracted.
3. Contract of the century was main reason why the famous Baku – Tbilisi – Ceyhan (BTC) pipeline was built. The geopolitical importance of this pipeline is immense, as it was the pipeline that took major volumes of Caspian oil directly to the international markets, bypassing any Russian influence. BTC was not only important to Azerbaijan, what we can see now BTC is important revenue source for Georgia, and additional export route for Kazakhstan and Turkmenistan.
4. In recent years, Azerbaijan has gone through major economic boom, and it was mainly due to the revenues from “The Contract of the Century”. The rise of the oil production had profound implication on country’s development. For instance, Azerbaijan’s state budget rose more than 15 times since year 2000. According to the World Bank 49.6% of population in 2001 lived below the poverty line, in 2008 this number came down to 15.8%³, given the fact that economic and social conditions within the country had further improvements in last few years poverty line surely reduced to the single digit. GDP indicators have changed as well, and it seems that economic achievements of the country look truly remarkable.

Source: World Bank⁴.

The role of “the Contract of the Century” has been immense in turning around fortunes for Azerbaijan. The capabilities of the country have

³ World Bank Database, <http://data.worldbank.org/country/azerbaijan>.

⁴ Ibidem.

changed, and the role of Azerbaijan in the region also changes. As President Aliyev said, due to its oil, Azerbaijan has become again in the center of attention of major powers that are competing for access to the resources⁵.

The country has become an active actor in the region and its economic potential has positive impact on the neighboring countries. For instance, spillover effects of economic growth in Azerbaijan on Georgia are tremendous. Azerbaijan has become number one foreign investor in Georgia, with investments into various sectors of economy. Turkey also enjoys the positive impact of hydrocarbon exports from the Caspian region, as well as Azerbaijan's major investments into petrochemical industry. Azerbaijan is transforming its approach in regional politics and becoming a source of a good will in the region. While, Armenia has become an isolated and stagnated country that is unfortunately being excluded from many regional projects due to its short sighted nationalistic policy. Azerbaijan nowadays prefers peace rather than war, recent short lived war in Georgia was good example that any regional disturbance would play against Azerbaijan's national interest. It is interesting that economic development of the country also leads to more sophisticated approach to the Karabakh conflict, where Azerbaijan proposes to provide economic incentives to Armenians to solve regional conflict. It is an excellent opportunity for the region to use windfall revenues from oil and gas resources to resolve long standing conflict through rapid economic integration and investments.

The contract of the century has changed economic landscape of the region, and also provided an opportunity to change geopolitical dynamics. Although it would be wrong to argue that Azerbaijan has become strong enough to resolve all regional issues and is now immune to regional geopolitical dynamics, Azerbaijan emerged nevertheless as an actor that pursues balanced policy and provides economic benefits to the neighboring countries.

Economically, as it has been shown above, Azerbaijan has gone through a decade of economic miracle that allowed country to heavily invest into the infrastructure and position Baku as a major hub in the region. There is a long list of things that yet need to be implemented for Azerbaijan to remain successful country. Nevertheless, one could see that the energy and

⁵ I.G. Aliyev, *Каспийская нефть Азербайджана*, "Известия" 2003.

foreign policy that was pursued by Heydar Aliyev in 1990s led to the fact that Azerbaijan is still ripping the benefits of those policies.

Streszczenie

Azerbejdżan jest położony w bardzo malowniczej, a jednocześnie potencjalnie burzliwej części świata, w której umyślnie bądź nieumyślnie kolidują interesy silnych państw. Od czasu uzyskania niepodległości Azerbejdżan przeszedł długą i trudną podróż. Ktoś, kto mógłby odwiedzić ten kraj, obecnie nie uwierzyłby, że zaledwie 20 lat temu trwała w nim wojna, z największą liczbą uchodźców na głowę mieszkańca na świecie, i że większość populacji żyła poniżej granicy ubóstwa. W niniejszym artykule opisano tę trudną podróż, w szczególności skupiając się na strategii energetycznej i jej wpływie na rozwój kraju i polityki zagranicznej. Autor omawia również dynamikę regionalną z punktu widzenia międzynarodowego stosunków, jak również z punktu widzenia przemysłu energetycznego.

Абстракт

Азербайджан расположен в очень живописном, и все же потенциально неспокойном регионе, где интересы великих держав намеренно или ненамеренно сталкиваются. С момента обретения независимости Азербайджан прошел долгий и трудный путь, и если кто-то посетит страну сегодня то трудно поверить, что в этой стране были активные военные действия 20 лет назад, где количество беженцев на душу населения в стране было самое высокое в мире, и большинство населения страны жило за чертой бедности. В этой статье рассматривается этот трудный пройденный путь что пережил Азербайджан, с акцентом на энергетическую стратегию и ее влияние на развитие страны и внешнюю политику. Также, рассматриваются динамика региона с точки зрения энергетические вопросы с точки зрения международных отношений в регионе.