
10. Azerbaijan's strategic choice in the Caspian region

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I. Introduction

Azerbaijan became independent on 18 October 1991, when its parliament adopted the constitutional act on state independence. Since then it has managed to determine and re-determine its objectives and priorities in the foreign and domestic spheres. These years have been years of search, doubt and disappointment, but also of hope and a certain success. The strategic goal of its governments has been to strengthen the country's independence and national security, and Azerbaijan has achieved palpable success on this road. Today it is recognized by the world community, is a member of many authoritative international organizations and financial institutions, maintains diplomatic relations with many countries, has attained considerable results in attracting foreign investments and is successfully integrating with the world economy.

Important elements in Azerbaijan's strategic choice in the Caspian region are: (a) the strengthening of political and economic relations with Western countries, particularly the USA; (b) the maintenance of stable political relations with Russia, Turkey and Iran; (c) the development of free trade with all countries; (d) the development of strategic partnership with the other members of GUUAM,¹ especially Georgia; (e) the delimitation of frontiers on the Caspian Sea; (e) assistance in the development of the Transport Corridor Europe Caucasus Asia (TRACECA);² and (f) the establishment of a diversified system of oil and gas pipelines.

This set of policy elements developed over several years. Under the first two presidents after independence, Ayaz Mutalibov and the late Ebulfez Elcibey—quite a brief period: the former led Azerbaijan for less than five months and the latter for only one year—work only began on the first three of them, although Elcibey, for instance, attached particular importance to the development of strategic relations with Ukraine. Mutalibov, unlike both Elcibey and the incumbent president, Heidar Aliyev, paid great attention to strategic cooperation with Iran and Russia. Elcibey gave primary attention to the development of strategic partnership with Turkey and regarded this, as well as expanding contacts with the West, as a key factor in strengthening national independence.

After Heidar Aliyev came to power in July 1993, Azerbaijan reconsidered its foreign political priorities. The first 8–10 months of his rule were characterized

¹ Georgia, Ukraine, Uzbekistan, Azerbaijan and Moldova. The grouping was originally created in 1997. Uzbekistan joined in 1999. See chapter 1 in this volume.

² See, e.g., the TRACECA Internet site, URL <<http://www.traceca.org>>.

by a predilection for Iran and Russia. Particular importance was attached to the relationship with Russia. Azerbaijan joined the Commonwealth of Independent States (CIS) in September 1993, presented the Russian company Lukoil with a 10 per cent interest stake (valued at some \$1 billion) in the 'Contract of the Century'³—the first oil contract between the Azerbaijan Government and foreign oil companies, signed on 20 September 1994—and demonstrated the opening of a new 'cold era' in relations with the West and even with Turkey. These swings in foreign policy over a short period are explained by the government's continuing search for a resolution to the Nagorno-Karabakh conflict.

Of the former republics of the USSR, except for Georgia, Azerbaijan has been the least lucky. After gaining independence it inherited the problem of ethnic confrontation between the Armenian population of Nagorno-Karabakh and the rest of Azerbaijan. The consequences are still palpable in many foreign policy actions. While developing relations with other countries, Azerbaijan has often had to view them through the prism of the Karabakh problem.

In July–December 1993, therefore, Azerbaijan's foreign policy priorities changed. It considerably improved its relations with Iran and Russia, generating hope that those two countries would be neutral on the issue of liberating the 20 per cent of Azerbaijan's territory that was occupied by Armenia. In early 1994 Azerbaijan started military operations aimed at liberating these territories, but it was soon halted and there were heavy casualties. It became evident that Russia, despite the concessions on the part of Azerbaijan mentioned above, considered Armenia as its strategic partner and would not accept Armenia being defeated in the war with Azerbaijan. Other factors also became obvious which made the choice of strategic partnership with Azerbaijan's southern neighbour, Iran, undesirable. These factors are analysed below.

Having discarded the idea of a northern or southern orientation, Azerbaijan therefore made its strategic political choice in favour of the West.⁴ It is by these priorities that its foreign policy is still governed.

II. Strengthening political and economic relations with the West

Having realized that in order to resolve the Nagorno-Karabakh problem it was necessary to oppose the Armenian–Russian alliance with a unity that was at least as strong, Azerbaijan set itself the goal of improving its economic and political relations with the West, especially with the USA. The only way to accomplish these goals was to resort to the 'oil card' and to offer the territory of

³ This first oil contract was given this name because of its immense value (\$7.4 billion) and the participation in it of many international oil companies from major countries.

⁴ There are no official documents of the government or parliament to corroborate this conclusion. These priorities are, however, unequivocally stated in Hasanov, A., [Azerbaijan's foreign policy: countries of Europe and USA, 1991–96], Baku, 1998 (in Azeri). Ali Hasanov heads one of the departments in the Azerbaijani Administration and is considered to be one of the people closest to Heidar Aliyev. Although his research is somewhat subjective where the assessment of previous administrations is concerned, which makes it difficult to agree with some of his conclusions, it nevertheless contains valuable factual material related to the foreign policy of the country and substantiates its foreign policy decisions.

Azerbaijan for the West's new strategic routes to Central Asia—in other words, it was necessary to return to the pro-Western course of the foreign policy launched under President Elçibey.

Elçibey understood clearly how important the possession of hydrocarbon resources was for the rapid development of relations with the West. Negotiations with foreign oil companies on the exploration and development of Azerbaijan's oil and gas fields, which had been started in 1990 by the USSR, were therefore accelerated after 1992, especially after Elçibey was elected president. He held meetings with executives of a number of international oil companies, first of all with Amoco which, following a 1991 tender, was working in cooperation with some other oil companies on a feasibility study for the development of the Azeri oilfields. All representatives of the international oil companies were informed by Azerbaijan's new government of its readiness to sign mutually beneficial oil contracts.⁵

As early as three months after Elçibey was elected, on 7 September 1992, an agreement was signed with the BP–Statoil consortium on the Chirag field and the Shah Deniz prospect area. The agreement gave BP–Statoil the exclusive right to prepare feasibility studies and draft contracts. Under the agreement, the consortium paid the Government of Azerbaijan a bonus of \$30 million. On 1 October the government also signed an agreement with the Pennzoil–Ramco consortium, whereby the latter agreed to implement a \$50 million gas recovery project on the Oil Rocks and Guneshli fields, where 1.5 billion cubic metres (bcm) of gas a year had been discharged into the atmosphere for many years, in exchange for the exclusive right to prepare a feasibility study for the Guneshli field.⁶ These agreements, which promised obvious economic benefits, also pursued political objectives. They demonstrated to the world the readiness of the new government of a newly independent country to cooperate in such a crucial sphere as the development of natural wealth and its preparedness for integration into the world economic system. An important political backdrop for the signing of the first of these agreements was a visit to Azerbaijan in September 1992 by former British Prime Minister Margaret Thatcher. Government ministers, congressmen and senators from different countries became frequent guests in Azerbaijan.

The Azerbaijan Government was fully aware of the importance of oil contracts for the economic and political independence of the country, and by signing various interim memoranda and agreements was moving in this direction. Thus, on 4 June 1993, on the very day when an anti-government insurgency in

⁵ The author, who held the positions of state adviser on strategic programmes and President of the State Oil Company of the Azerbaijan Republic (SOCAR), took part personally in almost all these meetings and witnessed these statements by President Elçibey.

⁶ The document signed with BP–Statoil was the Agreement between the Government of the Azerbaijan Republic and BP Exploration Operating Company Limited and Den Norske Stats Oljeselskap concerning the Appraisal and Development of the Chirag Field and the Shah Deniz Prospect Area. The document signed with Pennzoil–Ramco was the General Agreement on Terms and Principles for Concluding the Guneshli Field Development Contract. They were signed on behalf of Azerbaijan, on the instructions of President Elçibey, by the author of this chapter. The second was also signed by the first Vice-Premier of the Azerbaijan Government, Vahid Ahmadov.

Azerbaijan began which in two weeks led to the collapse of the Elcibey Administration, the Board of Directors of the State Oil Company of the Azerbaijan Republic (SOCAR) adopted a declaration on the unified development of the Chirag and Guneshli fields.⁷ This six-page document determined a number of key items in the contract prepared for signing—the shares of the foreign companies and SOCAR in the project, the volume of bonuses and schedule of their payment to the Azerbaijan Government, SOCAR's requirements for the establishment of special funds to finance primary operations, and so on. All the oil companies confirmed their agreement with the document within one week, and preparation and coordination of the main commercial terms of the future contract began. However, the anti-government insurgency, led by Colonel Surat Husseinov, was unfolding very rapidly and the government fell. Husseinov became prime minister and Heidar Aliyev, who had been elected speaker of the Azerbaijan Parliament on 14 June 1993, became acting president in July. In this complicated domestic political situation, work with foreign oil companies was suspended for a while.

Finally, on 20 September 1994 Azerbaijan signed its first oil contract on the Azeri, Chirag and Guneshli fields with BP Amoco, Statoil, the Turkish Petroleum Corporation (TPAO), Pennzoil, Ramco, Delta, Macdermott, Unocal and Lukoil.⁸ By November 2000 it had concluded 19 more agreements on the development of its on- and offshore fields. The total combined investment is expected to be worth around \$50 billion, while expected production is expected to be around 10 billion barrels (bbl) of oil and some 2 trillion cubic metres (tcm) of gas. On a world scale these figures are not very significant, especially since the contracts will run for 30–35 years. Azerbaijan cannot be compared with Kuwait or any other major oil producers. If the oil contracts are successfully implemented, Azerbaijan's annual production by volume will barely exceed 1.5 per cent of world output. Even so, for such a small country as Azerbaijan the production of hydrocarbons may play a great role in its economic development.

Oil companies from 14 countries (Belgium, Canada, France, Germany, Iran, Italy, Japan, Norway, Russia, Saudi Arabia, Spain, Turkey, the UK and the USA) are participating in oil contracts with Azerbaijan. These contracts have enabled Azerbaijan to establish close political contacts at the level of heads of state, to embark on the development of trade relations, and to win the trust of international organizations and financial institutions. In terms of foreign investment per capita, by 1998 Azerbaijan was ahead of all the other CIS countries.⁹

⁷ The document, called Declaration on Unitized Development of the Guneshli, Chirag and Azeri Fields, was approved by the SOCAR Board of Directors and signed by the author as President of SOCAR.

⁸ Later some of these companies sold their equity to other companies partially or fully.

⁹ According to a report from the Azerbaijani Ministry of Economics in *Mulkiyet*, 10–17 Nov. 1998, investment per capita in 1998 was worth in Azerbaijan \$172, in Russia \$90, in Kazakhstan \$72, in Uzbekistan \$75, in Georgia \$40 and in Armenia \$15. According to official data, foreign investment in Azerbaijan over the 5 years 1995–99 totalled \$4866 million. *Statistical Yearbook of Azerbaijan 2000* (Statistical Committee of the Azerbaijan Republic: Baku, 2000), p. 274 (in English).

It should also be mentioned that by signing oil contracts Azerbaijan immediately encountered opposition, first from Russia, then from Iran and more recently from Turkmenistan. Nevertheless, its example stimulated other littoral countries—Iran, Kazakhstan, Russia and Turkmenistan—to step up their operations in the Caspian Sea.

III. The policy of balanced relations with Russia, Turkey and Iran

Having become independent, Azerbaijan found itself in the centre of a geopolitical triangle dominated by Russia, Iran and Turkey, whose goals and interests in the comparatively small Azerbaijan differ. Each of these countries is, to a certain extent, a centre of power for Azerbaijan, but their powers are unequal. Iran today looks a little weaker than the other two, and Russia and Turkey are roughly balanced. Can Azerbaijan draw closer to one of the three by its own will? In principle, this is possible. However, the competing interests of the three countries may mean considerable losses for Azerbaijan, as has been proved by its brief historical experience: Azerbaijan is connected to each of the three by a multitude of historical, cultural, economic, ethnic and religious links, and the interest of these big neighbours in Azerbaijan is enhanced because this small country attracts other, more distant, countries by virtue of its mineral wealth and its geographical location—on the crossroads between the Western and Central Asian countries and in the vicinity of traditional rivals of these countries. All these circumstances require of Azerbaijan a rather careful and balanced foreign policy in the geopolitical triangle.

Azerbaijan and Russia

In 1992 Azerbaijan and Russia concluded a Treaty of Friendship, Cooperation and Mutual Security¹⁰ which was prolonged in 1997 by President Aliyev. It was supplemented by several dozen bilateral and multilateral agreements regulating military, political, economic and cultural cooperation between the two countries. However, relations between Azerbaijan and Russia are characterized by great mutual distrust, which is explained by Russia's strategic partnership with Armenia, to which Azerbaijan responded by strategic partnership with the West and the USA in particular.

There is sufficient reason today—numerous chauvinist statements by some Russian politicians, Russia's attempts to set up closer alliances with several post-Soviet states under its leadership, and its attempts to create supranational administrative organs in the CIS—to believe that Russia still aspires to pursue the model of the Soviet Union's relations with the 'socialist camp' countries, which ruled out any independent foreign policy decision making by them that did not agree with Soviet policy. This model has so far been effective with only

¹⁰ The treaty was signed in Moscow during an official visit of President Elcibey on 12–13 Oct. 1992.

some of the post-Soviet states, and obviously not with Azerbaijan. Russia is currently pursuing another, more realistic approach in its relations with Azerbaijan which is focused on economic aspects. In this respect, Lukoil, chaired by an ethnic Azeri, Vagit Alikperov, has achieved considerable success. It is in fact operating not only in the oil but also in other economic sectors in Azerbaijan. Nonetheless, Russia continues to apply considerable pressure both on the domestic political situation in Azerbaijan and on its foreign policy.

Several aspects compel Azerbaijan to reckon with the Russian factor.

The problem of Nagorno-Karabakh

Russia is trying to take advantage of the Nagorno-Karabakh conflict to the maximum extent possible by influencing Azerbaijan and trying to make it submissive. Having received the baton from the USSR, Russia quickly understood how important it was to preserve this means of putting pressure on Armenia and Azerbaijan and not to let the conflict fade away in order to complicate the strengthening of these countries' independence.

Russia has done a great deal in this regard. It is intensifying its military and strategic cooperation with Armenia, building up Armenia's military power, influencing domestic political developments in Armenia and impeding their development in the direction of independence. Paradoxical as it may seem, Russia, with the consent of Azerbaijan, is managing to remain co-chair of the Organization for Security and Co-operation in Europe (OSCE) Minsk Group¹¹ even though Azerbaijan clearly understands that Russia is interested in preserving the situation as it is now—neither peace nor war.

The land frontier between Azerbaijan and Russia is 285 km long, while their sea frontier on the Caspian is undefined. Both on- and offshore, the present territory of Azerbaijan was for centuries subject to Russian incursions, and after the Russian–Iranian wars of the early 19th century it was annexed to Russia. Today the likelihood of such attacks is rather hypothetical, but history compels Azerbaijan to exercise caution with regard to its great northern neighbour because of the war in Chechnya, in the vicinity of Azerbaijan's borders, and because there are two Russian military bases in Armenia.

The Russian population in Azerbaijan

The Russian population in Azerbaijan has been reduced by half in the past 10 years, to 150 000 or 2 per cent of the total population. The main reasons for the reduction are better living conditions in Russia than in Azerbaijan, the growing importance of Azeri as a state language and the need for the local Russian population to learn it because no attention was paid to it in Soviet

¹¹ The Minsk Group was set up by the Conference on Security and Co-operation in Europe (CSCE), the predecessor of the OSCE, in Mar. 1992 to monitor the situation in Nagorno-Karabakh. The members at the time of writing (2000) were Armenia, Austria, Azerbaijan, Belarus, Finland, France, Germany, Italy, Norway, Russia, Sweden, Turkey and the USA. See, e.g., Organization for Security and Co-operation in Europe, *OSCE Handbook* [2000], URL<<http://www.osce.org/publications/handbook/index.htm>>.

times. Even so, the presence of this insignificant Russian population seems to be excuse enough for Russia to remind Azerbaijan at the slightest opportunity of its concern for the fate of Russians living in Azerbaijan.

Azerbaijanis in Russia

The number of Azerbaijanis living in Russia is increasing by the day, not so much because of natural growth—there has long been an Azerbaijani population in Russia—but because Azerbaijanis are constantly arriving in Russia in search of work and a better life. According to the last Soviet census (1989) there were only 336 000 Azerbaijanis in Russia; currently, according to expert assessments made both in Russia and in Azerbaijan, they number 1.5–2 million. Again, Russia takes every opportunity to remind Azerbaijan of its ability to create unbearable conditions for the those who have found refuge in Russia and eventually to drive them out. Although this is not an official Russian policy reflected in any government documents, in the past several years cases of persecution, including in Moscow, have become frequent. This has been extensively reported in the media, including the Russian media.¹²

Russian cultural influence in Azerbaijan

More than 100 years of the colonial past, when the territory of Azerbaijan was part of the Russian Empire from 1812 to 1918, as well as 71 years of Russian domination during Soviet times could not but leave an indelible trace on the contemporary culture of the Azerbaijanis. The overwhelming majority are fluent in Russian, were influenced by Russian culture through literature, music and art, and hold these cultural values dear. There is also quite a large category of Russian-speaking Azeris who have been brought up in the spirit not of the Azerbaijani but of the Russian culture because they studied in secondary schools and universities in the Russian language. These Russian-speaking Azeris currently account for a considerable part of the local elite. Another manifestation of the Russian cultural presence is the popularity of Russian television channels, such as ORT, NTV and RTR, in Azerbaijan. There are as many of them as of Turkish channels and according to various surveys they are no less popular.

The network of Russian-language schools has not shrunk much, nor have Russian-language departments at universities. Russian theatre still functions and a number of Russian-language newspapers are published. An obvious information vacuum and an interruption in the supply of books and journals on many scientific, educational, cultural, sport and other issues (carrying not only Russian but also foreign information through the translation of foreign literature into Russian) followed independence but were only short-lived, and Azerbaijan's publishing market is once again filled with Russian-language editions.

¹² See, e.g., [Compatriot murdered in Russia], *Yeni Musavat*, 30 Nov. 2000 (in Azeri); [Crackdown in Moscow markets], *Azadlyg*, 24 Oct. 2000 (in Azeri); and Irzabekov, F., 'Azerbaijantsy v Rossii' [Azerbaijanis in Russia], *Sodruzhestvo NG* (supplement to *Nezavisimaya Gazeta*) no. 6 (28 June 2000).

Thus, although since 1992 cultural contacts between Azerbaijan and Russia have become less frequent, they are far from absent and there is no reason to speak of any cultural intolerance towards Russians.

Ethnic minorities residing in border areas

There are several ethnic minorities living in border areas. The largest of them is the Lezgins who live in the north-eastern Azerbaijan and south-eastern Russia. The total number of Lezgins in Azerbaijan according to the 1989 census is 170 000, or 2.4 per cent of the total population. Only an insignificant number live in the rural provinces bordering on Russia; the overwhelming majority live in Baku, the capital. There has been significant suspicion in Azeri society concerning support by the Russian secret services to nationalist Lezgin organizations which tried to instigate a separatist movement in northern Azerbaijan.¹³

The Russian military presence

After the collapse of the USSR, Azerbaijan was the first of the former Soviet republics to achieve the withdrawal of Russian troops from its soil. This happened in the spring of 1993. However, it did not result in a complete end to Russia's military influence. Most of Azerbaijan's arms and ammunition are of Russian origin. The majority of Azerbaijani officers were trained in the former Soviet Union and there is little reason to consider them independent of Russian influence. In the opinion of some experts the failures of the Azerbaijani Army in the military conflict with Armenia are explained by this very fact.

There is also direct military cooperation between Azerbaijan and Russia. Azerbaijan inherited one of the three largest Soviet radio location stations (RLSs), located in Gabala. While Latvia and Ukraine managed to close similar RLSs on their territories, the Gabala station remained under the Russian Army's control, although it is officially said to be leased. Paradoxically, while Azerbaijan has not joined the CIS air defence system, that system's largest military facility is located on its territory and is outside its control. The station enables electronic surveillance of the Indian Ocean and the Middle East—the regions with which Azerbaijan has been building new relations. The environmental impact of the Gabala RLS is extremely negative and the Azerbaijani public has been voicing its outrage and demanding its immediate closure. Trying to avoid damaging its relations with Russia, and especially with the Russian military, the Azerbaijani Government has not yet raised the issue of the immediate dismantling of the RLS. At the same time, no formal agreements have been concluded between Azerbaijan and Russia whereby the Gabala RLS could function on a long-term basis as a foreign military base, thus enabling Azerbaijan to earn money from the lease. An attempt to agree on leasing terms was made on the eve of and during Russian President Vladimir Putin's visit to Azerbaijan in

¹³ One such organization is Sadval, which operates in Russia.

January 2001, but the negotiations foundered on the issue of the lease period and no agreement was signed.¹⁴

Participation in Azerbaijan's oil projects

Azerbaijan allowed Lukoil to take part in the first consortium implementing the Contract of the Century. This gives Russia the possibility to influence the speed of implementation of the project and decisions on the selection of transport routes both for the 'early' and for 'main' oil.

Russia is unlikely to be interested in early implementation of Azerbaijan's oil projects, (a) because these projects accelerate the process whereby Western companies, and thus, naturally, the countries where they are based, 'tap' the Caspian region to which they were denied access for many years by the Soviet Union, and (b) because their implementation means the building up of Azerbaijan's economic potential and thus the strengthening of its political and economic independence.

Economic relations

Azerbaijan's economy was closely integrated into the economy of the USSR. After the breakup of the Soviet Union economic relations among its former constituent republics started to collapse. Nevertheless, Russia remained Azerbaijan's major foreign trade partner in 1999, being the largest in both imports (with 52.3 per cent of the total) and exports (with 30.7 per cent of the total).¹⁵

Azerbaijan and Iran

The territory of present-day Azerbaijan was taken over by Russia from Iran in the early 19th century. Logically, Iran should have been the first country to welcome Azerbaijan's independence. However, shortly after Azerbaijan adopted the Independence Act, Iranian Foreign Minister Ali Akbar Velayati stated that Iran intended to continue to deal with the Soviet Administration in Moscow.¹⁶ This could not but cause public outrage in Azerbaijan. Eventually Iran recognized Azerbaijan's independence, but its first reaction showed that there were reservations in its attitude towards Azerbaijan's independence. In other words, in addition to the mutual affinity between Azerbaijan and Iran, there was also distrust and caution in their relationship.

Three key factors draw the two countries together. The first is their centuries-long common history. Neither Azeris nor Iranians are indifferent to their history; they cannot forget or neglect their similar historical backgrounds. The second is ethnic similarity. Most Azeri Turks live in Iran, not in Azerbaijan;

¹⁴ Radio Free Europe/Radio Liberty (hereafter RFE/RL), *RFE/RL Newline*, vol. 5, no. 6, Part 1 (10 Jan. 2001).

¹⁵ *Azerbaijan Economic Trends: Quarterly Issue, Apr./June 2000* (European Commission, Brussels, Sep. 2000).

¹⁶ Personal communications of the author with senior Azeri politicians and experts.

according to different experts, they number between 20 and 30 million,¹⁷ 150–280 per cent more than the number in independent Azerbaijan. In fact, the number of Azeri Turks in Iran is comparable to the number of Persians, Iran's dominant ethnic group. The third is religious similarity: at least two-thirds of Azerbaijan's Muslim population are Shi'ite, like most Iranian Muslims.

Three main factors cause Iran concern or annoyance—Azerbaijan's strategic cooperation with the USA, its cooperation with NATO and the fact that it is a secular state oriented towards Western liberal values, which could be a dangerous example for the Iranian population. (The successful development of the economy and improving living standards in Azerbaijan are important pre-conditions for Azerbaijan's becoming a dangerous example for Iran. Azerbaijan has not yet reached this goal but the chances that it will succeed in doing this are very high taking into account its potential oil revenues, as long as they are efficiently utilized.)

A fourth factor is the nationalism of Azeri Turks living in Azerbaijan: if this nationalism were to spill over to the Azeri Turks living north-western in Iran it could encourage separatist sentiment there: this has already happened three times in the 20th century. Significant numbers of people in Azerbaijan, especially among intellectuals, consider the division of Azerbaijan into two parts a historical injustice. There is a non-government organization in Azerbaijan, the Integral Azerbaijan Union, the objective of which is to achieve the unification of Azerbaijan. It was founded in November 1997 and led by former President Elcibey. Its activity focuses on discussion of the problem of unification of northern and southern (Iranian) 'Azerbaijan'. The organization has not been registered by the Ministry of Justice for two years, but the government has not banned it either.

A fifth factor is Azerbaijan's affinity with Turkey. Iran and Turkey have historically been rivals in the region. Azerbaijan's proximity to Turkey cannot but perturb Iran, for two reasons: Iran does not forget that it once owned this territory; and Azerbaijan can supply Turkey with the hydrocarbon resources the latter badly needs, thus depriving Iran of a large market for its oil and gas. This might also mean that Turkey becomes more energy-independent.

Finally, the oil export route has caused Iran concern. The Azerbaijan Government has chosen the territories of Georgia and Turkey for the main export pipeline (MEP) despite Iran's effort to coerce Azerbaijan to lay the pipeline in its direction. Iran is not only losing potential economic dividends; it is also unable to control the export of hydrocarbons from the Caspian Basin.

Five main factors perturb Azerbaijan.

The first is Iran's cooperation with Armenia. Armenia has stated on many occasions that without its cooperation with Iran it would have been in a much

¹⁷ There are no official statistics of the number of Azeri Turks in Iran because no census in Iran has recorded the ethnic composition of the population. Specialists on Iran use different methods in evaluating the strength of different ethnic groups in its population, which leads to a diversity of opinion. E.g. Nasibli, N. (Azeri Ambassador to Iran 1992–93), [Unified Azerbaijan] (Ay-Ulduz, Baku, 1977) puts the number of Azeri Turks in Iran at 25 million, while Taghiyeva, S., [South Azerbaijan] (Orxan Publishers: Baku, 2000) puts it at 30–35 million.

more difficult situation. Numerous facts illustrate the negative effect this has on Azerbaijani–Iranian relations. Iran is aware of this but continues the policy of cooperation nonetheless. It should be admitted, however, that Iran has condemned Armenian separatism and has repeatedly supported Azerbaijan in the United Nations and at conferences organized by the Organization of the Islamic Conference (OIC). Iran is therefore pursuing a policy of double standards.

The second factor is Iran's support for the forces openly opposed to the Azerbaijan Government which are led by Mahir Javadov, brother of the late Rovshan Javadov who led the anti-government uprising in 1992. Mahir Javadov was also an active participant in the 1992 mutiny. After it was suppressed he fled to Austria. Since 1992 he has lived in Iran and has been castigating the present authorities and even threatening them.

Third, Iran's religious activities in Azerbaijan could be the basis for a political and ideological expansion of Iran in Azerbaijan, although this is most probably an illusion because the influence of Soviet atheist propaganda on the people of Azerbaijan remains too strong. A fourth issue is the national rights of Azeris living in Iran. Many politicians and intellectuals in Azerbaijan believe that the language of the Azeri Turks living in Iran and their culture must be recognized on an equal footing with Persian and enjoy official status and state support. Finally, there is Iran's position on the problem of the legal status of the Caspian Sea and its negative attitude to Azerbaijan's developing its oil and gas resources in the Caspian Sea, despite the fact that an Iranian oil company is participating in one of three projects there.

IV. The delimitation of sea frontiers on the Caspian Sea¹⁸

The issue of the status of the Caspian Sea was raised for the first time since the breakup of the Soviet Union in 1993. The discussion among the governments of the littoral countries was probably triggered by Azerbaijan's intensive negotiations with transnational oil companies concerning their involvement in the development of hydrocarbon resources in the previously closed Caspian. It should be remembered also that it was necessary to come to terms not only on the issue of the development of offshore fields but also on such issues as navigation, the utilization of fish stocks and the observance of environmental standards. From the very beginning of discussions on this issue it emerged that the countries involved had differing views on how to divide the sea. Over the years that followed the positions of almost all the littoral states were revised more than once.

Russia insists that until a new multilateral agreement on the Caspian Sea is signed the Soviet–Iranian agreements of 1921 and 1940 remain in effect. As far as a new agreement among all the littoral countries is concerned, Russia wants to divide not the Caspian Sea itself but its mineral resources. It proposes that

¹⁸ See also chapter 3, section III in this chapter.

the line of division be drawn not over the surface of the water but on the seabed. In accordance with this principle Kazakhstan and Russia signed an agreement in July 1998 On the Delineation of the Northern Part of the Caspian Sea Bed.¹⁹ Subsequently, in 2000 the Russian formula of 'dividing the seabed but keeping the water in common use' was supplemented with a proposal for joint development of borderline hydrocarbon resources on the principle of equal participation in corresponding projects.²⁰

Azerbaijan retained its initial position on the delimitation of the Caspian Sea until Putin's visit to Baku in January 2001. One of the results of this visit was an agreement between Azerbaijan and Russia on principles of cooperation in the Caspian Sea. They decided to resolve the issue of the legal status of the sea on a stage-by-stage basis and that the neighbouring and opposite states should divide the seabed into sectors or zones on the basis of a median line drawn in accordance with the principle of equal distance from the coastline, as well as on the basis of principles of international law and existing practice in the Caspian. The parties agreed that each of the littoral countries would have exclusive rights for the exploitation of mineral resources and other legal economic activities on the seabed in the sectors or zones formed as a result of this division.²¹

Thus Azerbaijan, following Kazakhstan and Russia, has backed down from its initial position in the interests of consensus among all the littoral states over the legal status of the Sea.

Turkmenistan supports Azerbaijan's position of division on the basis of the median line. However, it takes a different view of the methodology to be used: it wants the line to be drawn in the middle of geographical latitudes, while Azerbaijan wants it to run through points equally distant from opposite coasts. This would result in a number of oil and gas fields being disputed, including some of those already being developed. (Turkmenistan has claims on part of the Chirag field and the Azeri field, which are already being developed.)

Iran's position has shifted from the initial 'condominium' idea to the division of the Caspian into equal sectors, which it currently advocates. Such a division would be to the advantage of Iran because its coastline is the shortest of all the littoral countries.

Azerbaijan's support for the Kazakh–Russian approach may seriously influence the positions of Iran and Turkmenistan. If Turkmenistan also supports the formula proposed by Russia, which for a number of reasons is likely to happen, then Iran will find itself alone in opposition to the CIS group and it will be difficult and probably even counterproductive for it to stick to this position, because it would mean that nothing changes for Iran in the Caspian and it will continue to face the constraints on navigation that arise from the 1921 and 1940 agreements.

¹⁹ *Diplomaticheskij Vestnik*, no. 8 (1998), pp. 35–35.

²⁰ *Diplomaticheskij Vestnik*, no. 8 (2000), pp. 79–80.

²¹ ITAR-TASS, 9 Jan. 2001, in 'Russia, Azerbaijan issue statement on need for consensus on carving up Caspian', Foreign Broadcast Information Service, *Daily Report–Central Eurasia (FBIS-SOV)*, FBIS-SOV-2001-0109, 9 Jan. 2001.

V. A diversified system of oil and gas pipelines

The first research on possible routes for the transport of Azerbaijan's oil from the Guneshli and Azeri fields started in 1991, when Amoco, BP, Pennzoil, Unocal, J. P. Kenny and the Oman Oil Company were involved in in-depth investigations. A more thorough analysis of the technical and economic aspects of various routes for an export pipeline began in November 1992 after SOCAR, Amoco, BP and Pennzoil signed a memorandum of understanding on a common oil export pipeline. A working group of specialists from these companies started investigating seven principal directions for an export pipeline. Three of them ended in Black Sea ports (Novorossiysk, Poti/Supsa and Khopa), three at Turkey's Mediterranean terminal of Ceyhan, and one at Iran's Kharg terminal on the Persian Gulf.

Although calculations proved the Baku–Tbilisi–Poti/Supsa route to be the cheapest, this line, like any other with access to the Black Sea, had the considerable drawback that it involved subsequent transport through the Bosphorus and Dardanelles. The results of the research completed by late February 1993 and certain political factors laid the groundwork for the negotiations to be started with the governments of the neighbouring countries on the construction of an export pipeline through their territories. The Azerbaijan Government, however, considered the route to the Ceyhan terminal to be of higher priority. In early March 1993 an agreement was signed with the Turkish Government whereby the parties agreed on the main terms and tariffs of the construction of the Baku–Ceyhan pipeline through Turkey.²² Preliminary agreement was also reached with Iran and Georgia on corresponding alternatives to the route.²³

Interest in participating in the Baku–Ceyhan pipeline project as members of the future pipeline consortium, the Azerbaijan International Operating Company (AIOC),²⁴ was also voiced in the spring of 1993 by the ministries of fuel and energy of Kazakhstan and Russia.²⁵ Then, owing to the political situation in Azerbaijan, the negotiations on selection of the pipeline route came to a halt.

After the first oil contract was signed in September 1994, the decision on an export route for 'early oil' (32 million tonnes) became a priority. Azerbaijan needed to begin oil production in order to tackle its growing energy problems. It may also have believed that decision making on the MEP would be slow considering the conflicting interests of its powerful neighbours. Azerbaijan there-

²² Agreement between the governments of the Azerbaijan Republic and the Turkish Republic on Construction of the Pipeline, 9 Mar. 1993. The document was signed by the author of this chapter, at that time President of SOCAR, on behalf of Azerbaijan.

²³ The author of this chapter paid a special visit to Iran in Apr. 1993 to hold talks with the President of the National Iranian Oil Company (NIOC) concerning construction of a section of the Baku–Ceyhan pipeline through the territory of Iran. It was agreed then that negotiations should be continued and an agreement prepared on key conditions for the construction of the pipeline via Iran. A SOCAR delegation visited Georgia in Dec. 1992 and was received by President Eduard Shevardnadze.

²⁴ For the membership of the AIOC see chapter 3, section I in this volume.

²⁵ A letter of the Russian Ministry of Fuel and Energy to that effect, no. MT-3318, dated 24 May 1993, was signed by Minister Yuriy K. Shafrannik and addressed to the President of SOCAR. A similar letter from the Ministry of Energy and Fuel Resources of Kazakhstan dated 14 May 1993, no. 7-03-1450, was signed by the First Deputy Minister N. U. Bekbosinov and addressed to the President of SOCAR.

fore chose the early oil export route by June 1995 so that the AIOC could start production in accordance with the work schedule. In other words, the Azerbaijan Government and the AIOC decided where to export early oil before the decision on the MEP was made. The route for the MEP, according to the contract, was to be determined as part of the Minimum Required Work Program within 30 months.

However, the Azerbaijan Government failed to agree on the route for early oil by the deadline originally set (June 1995), hesitating between the Russian and Georgian alternatives. Financially the viability of the Georgian route was beyond doubt, but pressure from Russia was so strong that Azerbaijan eventually opted for the northern route as well. The decision on the Georgian route was arrived at during a telephone conversation between the Azerbaijan and US presidents on 2 October 1995. Not until 9 October 1995, on the basis of the earlier agreement with the Azerbaijan Government, did the AIOC decide on two routes for the export of early oil—northern, to the Russian port of Novorossiysk (with a capacity of up to 5 million tonnes of oil a year—mt/y); and Western, to Supsa in Georgia (with a capacity of up to 7 mt/y of oil).

Russia has thus managed not only to coerce Azerbaijan into choosing the northern route but also to obtain quite beneficial terms in exploiting this route. However, it seems to have over-exerted itself, because the AIOC has hardly used the route since the Baku–Supsa line was commissioned in 1999: calculations show that losses per tonne of exported oil amount to \$50–60 as a result of high transit fees and the mixing of high-quality Azeri oil with heavy West Siberian oil, while the Azerbaijan Government, having taken on the commitment to fill the pipe, is unable to do so.

After completing the development of the early oil export schedule in April 1996, the AIOC launched extensive work on the MEP project. In August 1996 SOCAR and the AIOC agreed on the official start of operations on the MEP and established the Strategic Management Committee (SMC).²⁶ The work programme, coordinated with the SMC, envisaged such operations as analysis of MEP options, market and risk evaluation, investigating financing prospects, talks with the governments of transit countries and so on.

In the initial stage of the research, the following routes for the pipeline were under consideration: (a) from Baku to Supsa (in Georgia); (b) from Baku to Tbilisi (Georgia) and thence Ceyhan (Turkey); (c) from Baku to Novorossiysk (Russia); (d) from Baku to Astarra (Azerbaijan) and thence to Tabriz (Iran) or Kharg Island (Iran); (e) from Samsun (Turkey) to Kyryk kala (Turkey) and then Ceyhan (Turkey); (f) the AMB (Albania–Macedonia–Bulgaria) route; (g) a route through Ismit (Turkey); (h) a Bulgaria–Greece route; (i) increasing the capacities of the northern and western routes for early oil; and (j) transport by sea from Baku to Bandar Anzali (Iran) and by pipeline to Aliabad (Iran), joining the pipeline to the Tabriz refinery. Then the options that involved transit through Iran were withdrawn because of political factors: the participation of

²⁶ The agreement on establishing the committee is available in the SOCAR and AIOC archives.

US companies in projects that would promote the economic development of Iran is prohibited by US legislation. Option (e) was withdrawn after being analysed by SOCAR and Botas. Option (f) was also withdrawn as it was considerably less cost-effective than option (h). Option (g) was withdrawn because the capacity of the Izmit refinery was insufficient.

Thus, the research focused on routes (a), (b) and (c). Since two of these ended on the Black Sea and because of the problem of oil transport through the Bosphorus and Dardanelles, the route bypassing the straits through Bulgaria and Greece was also reassessed.

The research produced the following conclusions. First, all three alternatives were technically viable. Second, all were within the definition of cost-effectiveness of the Azeri–Chirag–Guneshli contract, even with the volumes of oil specified in the contract. Third, the economic parameters of the two routes with their destination on the Black Sea were competitive compared to the Mediterranean alternative, even if they had to bypass the Bosphorus and Dardanelles. Fourth, it would be better to implement the MEP project on the basis of the Azeri–Chirag–Guneshli contract, so long as additional volumes were eventually assured, than to delay it in anticipation of the guaranteed oil export volumes from other projects. Fifth, the alternative of expanding the northern pipeline for early oil seemed competitive as an interim measure so long as the transition to full-field development (i.e., development of the contract area after the early oil production project) started before construction of the MEP was complete. Finally, the MEP could be constructed and put into service within 7–8 years, of which 1–2 years would be needed for the coordination and signing of agreements involving different parties such as transit countries, financing organizations, contractors and so on.

On the basis of these results, Azerbaijan chose the Baku–Tbilisi–Ceyhan (BTC) route as the one which met the interests of Azerbaijan best. This route was also supported by the governments of Georgia, Kazakhstan, Turkey, the USA and Uzbekistan. On 29 October 1998, all these countries signed the Ankara Declaration supporting the BTC route.²⁷ On 18 November 1999, at the OSCE Istanbul Summit Meeting, the presidents of Azerbaijan, Georgia, Kazakhstan and the USA signed the Istanbul Declaration in support of the BTC pipeline.²⁸

Then, in the first six months of 2000, a number of agreements were prepared and signed with the governments of host countries, as well as an agreement on Turkish Government guarantees to cover expenditure in excess of \$2.4 billion.²⁹

²⁷ The text of the Ankara Declaration was published in the Azerbaijani government gazette, *Khalq Gazeti*, on 5 Nov. 1998. After the signing it was also disseminated by leading news agencies worldwide.

²⁸ Interfax, 18 Nov. 1999, in 'Baku–Ceyhan oil agreements signed in Istanbul', FBIS-SOV-1999-1118, 18 Nov. 1999.

²⁹ These agreements were ratified by the parliaments of Azerbaijan on 25 May 2000, of Georgia on 31 May 2000, and of Turkey on 21 June 2000. The package of ratified documents includes the agreement between Azerbaijan, Turkey and Georgia on the transport of crude oil through the territories of these countries by means of the BTC MEP; agreements between the Azerbaijani, Georgian and Turkish governments and MEP investors; a turnkey agreement between MEP participants and contractors commissioning the facility on a turnkey basis; a letter of guarantee by the Turkish Treasurer which guarantees con-

Finally, in October 2000, a group of project sponsors was set up to finance engineering operations and agreements were signed with the governments of Azerbaijan, Georgia and Turkey. Eight companies—SOCAR (50 per cent interest in the group of sponsors), BP (25.41 per cent), Unocal (7.48 per cent), Statoil (6.37 per cent), TPAO (5.02 per cent), Itochu (2.92 per cent), Ramco (1.55 per cent) and Delta Hess (1.25 per cent)—joined the group of project sponsors. All except Ramco are partners in the AIOC. Sponsors will automatically become members of the Main Export Pipeline Company (MEPCO), a new consortium, which will finance, build and operate the pipeline.

Construction of the BTC pipeline is expected to take 36 months and the filling of the pipe another 5–6 months, while the project is expected to cost \$2.4 billion.³⁰ The 1022-mm pipeline, with a capacity of 50 mt/y, will be 1730–1830 km long, with stretches of 1037 km running through Turkey, 250–350 km through Georgia and 468 km through Azerbaijan.

Three risks remain. They relate to the availability of oil to fill the pipe, the price of crude and the mobilization of financial resources. Azerbaijan's proven oil and condensate reserves already exceed 7 bbl, of which some 2 bbl will be needed for domestic needs within 30 years.³¹ The rest will be exported. Some 1 bbl of this can be expected to be transported through Novorossiysk and Supsa because Exxon/Mobil, Lukoil, Devon and Amerada Hess have so far refused to take part in the BTC project, even though they are part of the production contract. Four bbl remain, which may not be sufficient to ensure profitability of the pipeline with a base price of \$15 per barrel. However, so far exploration operations have been carried out on only one-quarter of the licence area on the 20 oil contracts which Azerbaijan has signed. Experts believe that the discovery of new oilfields can be confidently expected. It is also believed that part of the oil from Kazakhstan's gigantic new oilfields will also be transported through the BTC pipeline. Kazakh oil—15 million barrels a year—is already being transported through Azerbaijan and the volume has been increasing. Construction in future of a trans-Caspian pipeline, which would connect Aktau in Kazakhstan with the BTC pipeline, is not ruled out either.

Lukoil has not yet joined the BTC project for two reasons: (a) Russia's negative attitude to the project; (b) and the fact that Lukarco holds a 12.5 per cent share in the Caspian Pipeline Consortium (CPC)³² and is interested in using that pipeline. However, Lukoil may join the project at the construction stage or during exploitation. It can be confidently expected that after the BTC pipeline is built Lukoil will want to export a part of its oil to the Mediterranean, particularly as it is going to have such oil in the wake of the discovery of major

struction and commissioning, within the previously established period and in accordance with the previously established prices, of the Turkish section of the MEP project; the Istanbul Declaration; and the protocol on the introduction of changes to the agreement between Azerbaijan, Georgia and Turkey on the transport of crude oil through these countries by means of the BTC MEP, signed on 9 May 2000.

³⁰ Caspian News Agency, 21 June 2000.

³¹ During 1995–99 Azerbaijan's average domestic consumption was 45–50 million barrels of oil per annum. It is expected to reach 65–70 million barrels per year over the next 30 years. Thus, over 30 years Azerbaijan will consume a total of 2 billion barrels of oil.

³² For the shareholders in the CPC see chapter 3, section I in this volume.

oilfields in the Caspian Sea. After construction of the BTC line starts it is not ruled out that Russia, having acknowledged its defeat in the struggle for construction of the MEP through its territory, will stop boycotting the route and try to gain something from it. After all, Russia is selling gas to Turkey and is building a new gas pipeline to Turkey in implementing the Blue Stream project.

As far as world oil prices are concerned, there are reasons to believe that they are unlikely to fall to less than \$15 per barrel, which has been accepted by the AIOC as the base price. Prices are more likely to rise a little in the future, which will, of course, contribute to the profitability of the project.

The risks related to mobilization of financial resources for the project remain, but there have been reassuring statements by senior US officials that the project will be supported by a number of US financial institutions. There are also similar statements by other international financial institutions.³³

VI. Conclusions

This chapter does not aim to be a comprehensive and detailed analysis of Azerbaijan's strategic choice of its foreign policy priorities since independence. These priorities were formed gradually under the influence of both external and internal factors and on the basis of the country's national interests in the present stage of its development. In these nine years, Azerbaijan has aspired to strengthen its independence through integration with the world's political organizations and to form stable and normal relations with many countries, and first of all with its neighbours, thus laying the groundwork for sustainable economic development in the future. It has done much towards achieving these goals in the years of independence. Much remains to be done to promote sustainable development, but there appears to be sufficient reason to believe that this course is the one that has been irrevocably chosen.

³³ E.g., in an interview given in July 2000 in Tbilisi, Deputy Executive Director of the International Financial Corporation (IFC) and Managing Director of the World Bank Group Peter Voyk expressed the IFC's readiness to take part in financing the BTC project 'if necessary'. Caspian News Agency, 17 July 2000.