

## AZERBAIJAN'S ENERGY POLICY: RESULTS, PROBLEMS, PROSPECTS

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### ABSTRACT

**F**ollowing the dissolution of the U.S.S.R. Azerbaijan gained an opportunity to shape its energy policy based on its own national interests. In the several years after attaining independence, Azerbaijan's

energy policy was heavily influenced by internal events related to the power struggle within the Azerbaijani elite. This impeded the expansion of Azerbaijan's cooperation with Western oil and gas companies, which

expressed an increased interest in this Caspian state's petroleum resources. Internal political struggles did not affect the country's energy policy priorities. The latter involved, first and foremost, the choice of strategic partners for cooperation that would allow Azerbaijan to expect an increase in oil and gas production. The choice was made in favor of foreign petroleum companies and strengthening relations with Western states. Their support played a key role in further development of petroleum fields and the choice of routes for oil export.

Between 1991 and 2017, Azerbaijan's energy policy went through several stages. In the early 1990s, Azerbaijan focused on oil production, engaging Western petroleum companies, whose interest was sparked by evidence of considerable petroleum reserves, in field development. Azerbaijan possessed well-developed infrastructure and experienced personnel, and had long-standing oil production traditions that arose in the 19th century, when Baku was the world capital of oil production. The key goal of Azerbaijan's energy policy was not merely to increase Caspian oil field production volumes, but also to construct new pipelines that would ensure the delivery of Azerbaijani oil to export markets. Azerbaijan managed to achieve substantial progress in this area, having built new pipelines for exporting oil

with the assistance of the petroleum business community and Western countries. In addition, the surge in oil production volumes allowed Azerbaijan to stabilize the political situation and resolve social and economic issues that emerged following the disintegration of the Soviet Union due to the disruption of trade and economic bonds with ex-Soviet republics.

In the early 21st century, Azerbaijan's energy policy underwent a major transformation. Having begun its development as an oil state, Azerbaijan has consequently focused on developing gas fields that were discovered in the course of oil field development. Proven gas reserves and gas production volumes allowed Baku to plan an increase of exports to outside markets.

In recent years, Azerbaijan has been pursuing an energy policy that aims to secure its role as a petroleum resource exporter to European countries. The expansion of cooperation with Turkey is contributing to the resolution of this issue. Cooperation between Azerbaijan and Turkey allowed to begin the implementation of new gas pipeline projects, the construction of which will increase the volume of Azerbaijan natural gas deliveries to outside markets. Azerbaijan's energy policy is in keeping with EU interests, which regards Caspian energy resources as an alternative to Russian gas export.

**KEYWORDS:** Azerbaijan, energy policy, pipelines, oil, gas, international legal status, Russia, the U.S., EU, Turkey.

## *Introduction*

After gaining independence in 1991, Azerbaijan had focused on the development of the country's fuel and energy complex. The primary focus was on increasing production of hydrocarbon resources and shaping new routes of their export to outside markets. Caspian oil has once again acquired an exceptionally great significance, becoming the foundation of economic development for the countries of the region<sup>1</sup>.

<sup>1</sup> G.I. Starchenkov, "Neft Kaspia i puti ee transportirovki," in: *Musulmanskie strany u granits SNG*, Institute of Oriental Studies, Kraft+, Russian Academy of Sciences, Moscow, 2001, p. 298.

Unlike Kazakhstan and Turkmenistan, which also possessed considerable reserves of hydrocarbon resources, Azerbaijan enjoys a far more favorable geographic location. In addition, Azerbaijan had the experts, who accumulated enormous experience in developing oil- and gas-bearing regions around the Caspian Sea.

Prospecting data obtained during the Soviet Union's existence also played its role. This information had largely pre-determined the vector of Azerbaijan's energy policy and assured the success attained by the country in producing energy commodities after gaining independence.

## Sources of Energy Policy

After the dissolution of the U.S.S.R., Azerbaijan became a focus of the Western countries' attention due to its geographic location. The country could export hydrocarbon fuels to the North, in the direction of Russia, as well as to the West, which immediately became a priority. The Western states attached great significance to the issues of oil production in Azerbaijan and the direction of its export. A discussion of pipeline projects that would bypass Russian territory and provide Azerbaijan's hydrocarbon fuels with direct access to outside markets was initiated with active participation of the Western states. In 1992, a meeting took place in Turkey where major Western oil companies' representatives proposed the idea of transporting Caspian oil from Baku through Turkey into the port of Ceyhan. In fact, this is when the "great game" for Caspian oil began.<sup>2</sup>

Russia also placed great emphasis on the direction of Azerbaijan's oil export, attempting to influence the country's politics. As a result, the pipelines became a burning issue in Russia's foreign policy, and, concurrently, one of the key instruments in the struggle to maintain a dominating position in the region<sup>3</sup>.

Azerbaijan attempted to derive political and economic benefits from the competition between Russia and the West, becoming one of the initiators of accelerated development of Caspian oil fields and construction of new export pipelines. The focus was placed on engaging Western states and oil companies in oil field development. This was the course pursued by President Ayaz Mutalibov, who was an adherent of expanding cooperation with the West.

The implementation of these ambitious plans was hindered by the complicated political situation in Azerbaijan. As a result of a political struggle, Abulfaz Elchibey came to power in March 1992. The new head of Azerbaijan was also an adherent of engaging Western oil companies in oil field development, and advocated limiting Russia's participation in Azerbaijan's oil and gas field development. In the fall of 1992, British Petroleum (U.K.), Statoil (Norway), Amoco and Unocal (U.S.) have finally signed an agreement for joint development of Gunashli, Azeri and Chirag oil fields, and Shah Deniz prospective area with the State Oil Company of the Azerbaijan Republic (SOCAR).

Azerbaijan's aim to promptly proceed with hydrocarbon resource development was deterred by a number of issues. One of them was the lack of infrastructure required for oil export<sup>4</sup>. This has led to the development of several pipeline projects that were supposed to ensure unhindered entrance of Azerbaijan's oil to outside markets. Chief interest was aroused by the *Baku-Tbilisi-Ceyhan (BTC) pipeline* project. In March 1993, Azerbaijan and Turkey have signed an agreement in Ankara regard-

<sup>2</sup> S. Shermatova, "The Oil Factor in the Chechen Conflict," *Central Asia and the Caucasus*, No. 5 (11), 2001, p. 71.

<sup>3</sup> S.S. Zhiltsov, I.S. Zonn, *Kaspiiskaia truboprovodnaia geopolitika: sostoianie i realizatsia*, Vostok-Zapad, Moscow, 2011, pp. 52-63.

<sup>4</sup> E. Ismailov, E. Polukhov, "The 'Old' and 'New' Players in Caucasian Politics," *Central Asia and the Caucasus*, No. 4 (28), 2004, pp. 46-54.

ing the construction of a 1920 km-long pipeline with a capacity of 50 million tons per year, with a projected cost of \$3 billion.<sup>5</sup>

This project was promoted by Turkey, whose interest in Azeri, Gunashli and Chirag was a significant one. Utilizing its beneficial geographic location, the existence of port infrastructure for transporting Caspian oil, and also relying on U.S. support, Turkey aimed to play an increasingly more active role in the Caspian region, participating in the export of Caspian hydrocarbon resources to outside markets. In turn, cooperation with Turkey provided Azerbaijan with new opportunities for oil export bypassing Russian territory. Baku tried to enlist the support of Western countries and oil companies on this issue. Azerineft has signed a declaration of joint development of Gunashli, Azeri, Chirag and Shah Deniz in the Azerbaijani part of the Caspian Sea with consortium representatives in London in June 1993<sup>6</sup>. Long-term negotiations were supposed to end with the signing of the agreement on developing Azerbaijan's oil fields. However, it was once again hindered by internal political events. In June 1993, Abulfaz Elchibey was removed from power, and in September of the same year Heydar Aliiev became president. The change of leadership in Azerbaijan temporarily suspended the implementation of the agreements reached, but did not lower foreign companies' interest in Azerbaijan's oil fields.

## Azerbaijan's Reliance on the Western States

After his assumption of power, the new president revitalized the process of negotiations with international oil and gas companies. Azerbaijan actively pursued an energy policy aimed to prepare the signing of an agreement related to the development of its oil and gas fields. In the first half of 1994, Azerbaijan's leader visited a number of European countries (France, the U.K.), and signed political, economic and trade-related agreements with them. For example, in February Heydar Aliiev and Prime Minister of the United Kingdom John Major signed an agreement in London, which was related to oil production sphere, wherein the governments of the two countries guaranteed the compliance of British Petroleum and SOCAR with their obligations. This document established the term "Azerbaijan's sector of the Caspian Sea." This approach by Baku aimed to strengthen its positions in negotiations with Western oil and gas companies, for whom the lack of clarity in the international legal status of Caspian Sea increased the financial and political risks of developing Azerbaijan's Caspian Sea hydrocarbon resources. During the same time period, Azerbaijan signed a number of documents on conducting research work at several fields in Azerbaijan. For example, Schlumberger, a French company, was engaged in conducting geophysical exploration at the Gunashli field.

Azerbaijan's efforts directed at engaging Western companies in cooperation have yielded their results. On 20 September, 1994, Azerbaijan signed a contract with major foreign companies for the development of oil fields on the Caspian shelf (Azeri, Gunashli, Chirag), called "the contract of the century." Azerbaijan's expenses constituted 24% of the total cost, while its revenue equaled 76% (approximately \$99 billion)<sup>7</sup>. At a later time, President of Azerbaijan Heydar Aliiev noted that the "signing of the 'contract of the century' on 20 September, 1994, marks the beginning of an oil strategy and the independent Azerbaijan doctrine."<sup>8</sup>

<sup>5</sup> O. Kasenov, "Transcaucasia and Central Asia: Oil, Pipelines and Geopolitics," in: *Central Asia: Conflict, Resolution and Change*, ed. by Roald Z. Sagdeev and Susan Eisenhower, CPSS Press, Chevy Chase, Maryland, 1995, pp. 67-79.

<sup>6</sup> I.S. Zonn, *Kaspiiskiy memorandum*, Korkis, Moscow, 1997, pp. 39-40.

<sup>7</sup> V.V. Shorokhov, "Neft i politika Azerbaidzhana," *Issledovaniya TsMn MGIMO*, № 9, 1997, p. 65.

<sup>8</sup> I. Aliiev, *Kaspiiskaia neft Azerbaidzhana*, Izvestia, Moscow, 2003, p. 475.

In economic terms, the “contract of the century” provided Azerbaijan with an opportunity to bring its oil to the European market, creating the basis for developing other prospective fields. This promoted major investments in oil-related sectors, replenishment of currency reserves, and adopting an active investment policy.

After signing a contract with oil and gas companies, Azerbaijan aimed to gain Iran’s support. Baku’s commitment to expanding its cooperation with Iran was dictated by the negative reaction of Russia, which opposed the “contract of the century.” In November 1994, the Iranian and Azerbaijani sides signed a document, according to which Iran could be considered a party to the “contract of the century” through Azerbaijan’s assignment of a part of its share to Iran<sup>9</sup>. Azerbaijan’s efforts were directed at shifting Iran’s position on the international legal status of the Caspian Sea. Baku was also striving for Tehran to agree to a sectoral method of dividing the Caspian, especially since the new Constitution of Azerbaijan stated that “internal waters of the Azerbaijan Republic, sector of the Caspian Sea (lake) belonging to it, air space over the it are integral parts of the territory of the Azerbaijan Republic” (Art 11).

The arrangements between Azerbaijan and Iran could have left Russia on its own on the issue of regulating the status of the Caspian Sea. Moreover, Iran’s acknowledgement of the “contract of the century” could raise doubts about the Soviet-Iranian agreements of 1921 and 1940. However, Baku’s plans were not about to be fulfilled. The U.S. opposed Iran’s participation in developing Azerbaijan’s oil fields. In April 1995, under pressure from the U.S. side, Azerbaijan declared the exclusion of Iran from the consortium.

The conclusion of the “contract of the century” for the development of Azerbaijan’s Gunashli, Chirag and Azeri offshore fields once again drew attention to the ways of transporting oil which was to be produced in the future. Considering the significant volumes of future oil production, a decision was made to divide the produced oil into “early” (whose volume was supposed to reach 5 million tons per year by the end of the 20th century), and “late,” or “principal”—30-40 tons of oil annually that was scheduled to be produced in Azerbaijan’s offshore fields by 2015.<sup>10</sup>

## Diversifying Export Routes of Hydrocarbon Resources

In the early 1990s, Azerbaijan’s energy policy was determined by the development of the oil and gas complex, as well as by the stance taken by the Western states. In addition, the flywheel of political advertising related to the existence of significant hydrocarbon reserves in Azerbaijan justified the need for building new pipelines to transport oil out of the Caspian region.

The chief focus was on selecting the direction of Azerbaijan’s oil deliveries—either Russia or Europe. The U.S., which pursued an active policy in the region, was interested in obstructing Azerbaijani hydrocarbon exports through the Russian territory, since the export route through the port of Novorossiysk would allow Russia to have influence over Baku. Pumping oil through the pipelines towards Russia was considered a threat to the geopolitical interests of the West. However, despite the pressure from the U.S. and EU, Azerbaijan strived to pursue a balanced policy, not in a hurry to sever relations with Russia. It was steered in this direction by the lack of precise terms of the implementation of the new pipeline projects, which raised enormous interest, yet did not translate into reality. As a result, Baku signed an agreement with Russia on transporting oil through to Novorossiysk in January 1996. However, the Russian route, which passed through Chechnia, immediately began

<sup>9</sup> I. Aliev, op. cit., p. 182.

<sup>10</sup> Yu.E. Fedorov, *Kaspiiskaia nefi i mezhdunarodnaia bezopasnost*, Moscow, 1996.

encountering difficulties. Finally, along with the discussions related to Azerbaijan's oil delivery to Russia, the western route—*Baku (Azerbaijan)-Supsa (Georgia) pipeline* (the Azerbaijani segment constituted 492 km from Sangacal to the Georgian border)—also came into focus. The pipeline required a reconstruction of a 425 km segment on the Georgian territory, while its entire length was 917 km. It could ensure transit of 5 million tons of oil per year. In March 1996, the presidents of Azerbaijan and Georgia signed three agreements related to the transportation of Caspian oil through Georgia, as well as an agreement on the construction and maintenance of the Baku-Supsa pipeline. Considering the great variability of export pipelines, new agreements were concluded in March 1997 between Azerbaijan and Georgia on the delivery of oil along the Baku-Tbilisi-Supsa route, with access to the Black Sea.

However, the main attention of Azerbaijan and Western states was devoted to the Baku-Tbilisi-Ceyhan pipeline project, which was intended for the delivery of Caspian oil to the West. In June 1997, the concept of *Main export pipeline (MEP)* was introduced, reflecting the changes in Azerbaijan's energy strategy. Baku concentrated on the realization of MEP, aiming to engage other Caspian states in the project. In September 1997, the president of Kazakhstan Nursultan Nazarbayev for the first time called the Turkish route through Azerbaijan and Georgia to port Ceyhan “the safest and most important for Kazakhstan” and expressed his hope for the speedy construction of the *Aktau-Baku underwater pipeline*.

In implementing its energy policy Azerbaijan relied on the support of Western countries. For example, the U.S. had justifiably assumed that the Baku-Ceyhan project will strengthen its position in the strategic Caspian region, on the one hand, and will decrease the dependence of the ex-Soviet republics on Russia and the Baku-Novorossiysk route, on the other. Eventually, as the U.S. administration projected, it should weaken the position of Russia in the Caspian region. In late 1997, two more Baku-Ceyhan pipeline construction-related agreements were concluded in Baku.

In 1999, Azerbaijan attained the first results in diversification of its oil export routes. Azerbaijani international operational company—a consortium with participation of major Western oil companies and the State Oil Company of the Azerbaijan Republic have completed the construction of the *Baku-Supsa pipeline*, which was built on the foundation of the old Baku-Batumi oil pipeline<sup>11</sup>. The pipeline spans 850 km through Georgian territory. The capacity of the oil pipeline intended to transport “early” oil constitutes 6 million tons per year. In the future, the volume was supposed to increase to 10 million tons of oil per year<sup>12</sup>.

In April of the same year, this pipeline began delivering “early” Azerbaijani oil from the Chirag field. As a result, the Baku-Supsa pipeline began competing with the Baku-Novorossiysk route, although its transit capacity was several times smaller. The Baku-Supsa pipeline not only provided Western companies with non-obstructed access to Caspian coastal fields, but also created a safe route for oil export to outside markets, and increased the country's budget revenues. In 1999, a state oil fund was created in Azerbaijan in order to accumulate funds<sup>13</sup>.

For the Western countries, the commission of the pipeline meant the decline of Russian influence on Azerbaijan. Just as important was its geopolitical significance, as it strengthened the relations between Azerbaijan and Georgia, whose role in the transportation of Caspian hydrocarbon resources increased sharply.

In 1999-2001, the main documents aimed at the implementation of the Baku-Tbilisi-Ceyhan project were signed. In May-June 2000, the parliaments of Azerbaijan, Georgia and Turkey ratified

<sup>11</sup> A.K. Bystrova, *Problemy transportnoi infrastruktury i ekologii v Kaspiiskom regione*, IMEMO, Moscow, 2009.

<sup>12</sup> S.S. Zhiltsov, I.S. Zonn, A.M. Ushkov, *Geopolitika Kaspiiskogo regiona*, Moscow, 2003, p. 114.

<sup>13</sup> K. Aslanli, “Fiscal Sustainability and the State Oil Fund in Azerbaijan,” *Journal of Eurasian Studies*, No. 6, 2015, pp. 114-121.

the package of previously concluded agreements related to the Baku-Tbilisi-Ceyhan pipeline construction. In early 2000, a State Commission was created per the Georgian president's orders, indicating the project's great importance for Georgia. It was supposed to deal with the organization of Caspian basin oil and gas resources delivery through Georgian territory.

In the early 2000s, Azerbaijan began to abandon its harsh stance on the sectoral division of the Caspian Sea. The change in Azerbaijan's approach to this issue resulted in the signing of an agreement with Russia and Kazakhstan regarding the junction point of the demarcation lines between adjoining areas on the bottom of the Caspian Sea. The settlement of the international legal status in the northern part of the Caspian Sea served Azerbaijan's interests,<sup>14</sup> since the development of offshore mineral resources gained an international legal foundation, which provided an impulse for further research and development of oil and gas fields<sup>15</sup>.

In 2005, the Baku-Tbilisi-Ceyhan pipeline was completed. The implementation of this project further weakened Azerbaijan's dependence on exporting Caspian oil to Russia. As a result, the Baku-Novorossiysk pipeline, which had previously allowed Russia to influence Azerbaijan's oil policy, lost its strategic importance<sup>16</sup>.

The construction of the Baku-Tbilisi-Ceyhan pipeline provided additional opportunities for Azerbaijan to export its hydrocarbon resources. Concurrently, Baku faced the problem of pipeline fill, since the rate of production lagged far behind the previously made forecasts. In order to resolve this issue, Baku began considering the option of engaging Kazakhstan in the hydrocarbon export pipeline project. Azerbaijan and Kazakhstan's negotiations resulted in the conclusion of a strategic partnership and allied relations in 2005. The president of Kazakhstan stated that his country has joined the Baku-Tbilisi-Ceyhan project, noting that the pipeline should hereafter be called Aktau-Baku-Tbilisi-Ceyhan<sup>17</sup>. The idea of the necessity of constructing a pipeline between Aktau and Baku with a capacity of 20 million tons per year emerged<sup>18</sup>. However, the agreement on Kazakhstan's affiliation with this pipeline project was never implemented. Aside from technical issues and the unsettled international legal status of the Caspian Sea, Kazakhstan's energy policy focused mainly on pumping oil through the Caspian pipeline consortium (CTC), which delivered Kazakhstani oil to Russia. In addition, this was the period when Kazakhstan's relationship with China in the energy sphere was developing further.

In 2006, Kazakhstan and Azerbaijan once again began discussing the possibility of launching the Trans-Caspian project. In June of the same year, the presidents of Azerbaijan and Kazakhstan signed a new agreement on facilitation of oil transportation from Kazakhstan through the Caspian Sea, Azerbaijan, and then further on via the Baku-Tbilisi-Ceyhan pipeline. This concerned the delivery of oil from Kazakhstan's Kashagan field to Black and Mediterranean Sea coasts via Azerbaijan.

The constantly strengthening Kazakhstan-Azerbaijan axis aimed to form an energy corridor, which could allow Kazakhstan's resources to enter the European market. The first stage involved an increase in Kazakhstan oil delivery by tankers. Crude oil produced at the Tengiz field was to be delivered from port Aktau to Azerbaijan, and then pumped into the Baku-Tbilisi-Ceyhan pipeline. The oil flow was intended to start at 2 million tons and grow to 5 million tons. The volume of tanker deliveries from Kazakhstan to Baku was supposed to be brought up to 20-25 million tons<sup>19</sup>. The Aktau-

<sup>14</sup> *The Caspian Sea Chessboard*, ed. by C. Frappi, A. Garibov, Institute for International Political, Baku, 2013, pp. 93-111.

<sup>15</sup> M.R. Hafeznia, H. Pirdashti, Z. Ahmadipour, "An Expert-Based Decision Making Tool for Enhancing the Consensus on Caspian Sea Legal Regime," *Journal of Eurasian Studies*, No. 7, 2016, pp. 181-194.

<sup>16</sup> M.A. Kaimarazova, "Prikaspiiskie territorii Rossii i sopredelnykh gosudarstv v novykh geopoliticheskikh usloviakh," in: *Sbornik dokladov mezhdunarodnoi nauchnoi konferentsii "Rossiiskaia politika sosedstva," Moskva, 12-13 October, 2007*, Moscow, 2008, p. 434.

<sup>17</sup> "Kazakhstan prisоеdinilsia k projektu Baku-Tbilisi-Ceyhan," *Vestnik Kaspia*, No. 3, 2005, p. 71.

<sup>18</sup> M. Zaslavskiy, *Delo truba*, Evropa, Moscow, 2005, p. 84.

<sup>19</sup> *Ibid.*, p. 29.

Baku segment was expected to act as an independent transportation route. With this purpose in mind, the construction of a new terminal for storing and pumping oil in the Kuryk village (a port 76 km to the southeast of Aktau), as well as a number of connecting pipelines, were intended.

In January 2007, a memorandum of understanding was signed regarding the creation of a Kazakhstan Caspian oil transportation system, intended for tanker export of Kazakhstan oil via the Caspian Sea. The capacity of this system was supposed to be raised to 25 million tons with a further increase to 38 million tons. The system's commissioning was planned for 2012-2013, when oil production was supposed to start at the Kashagan field in Kazakhstan. In this manner, Azerbaijan and Kazakhstan have closely approached the joint implementation of the Trans-Caspian project, which involved crude oil loading terminals on Kazakhstan's coast, tankers, and a connective system to the Baku-Tbilisi-Ceyhan pipeline, which was in dire need of additional oil volumes.

The difficulties linked to production in its own fields preserved Azerbaijan's interest in Kazakhstani oil. In October 2010, Kazakhstan and Azerbaijan have once again begun negotiations on the development of the feasibility study of the Trans-Caspian route. It involved future deliveries of the oil produced at the Kashagan field to the Baku-Tbilisi-Ceyhan pipeline. However, the Kazakhstan side kept postponing the beginning of production at the field.

The possibility of Kazakhstan's participation in the operations of the Baku-Tbilisi-Ceyhan pipeline was largely pre-determined by this country's oil production volumes. In 2010, the country produced approximately 81 million tons of oil, most of which was exported to Russia. Furthermore, the build-up of oil production has met with a number of difficulties, which made Kazakhstan authorities lower the estimated figures projected at the turn between the first and the second decades of the 21st century. For example, it was originally expected that the Kazakhstan annual oil production volume will reach 130-135 million tons in 2015. These figures were consequently altered. According to the forecast, the production in 2015 should amount to 100 million tons per year, and 130 million tons in 2018-2020.<sup>20</sup> By the middle of the second decade of the 21st century, Kazakhstan's lack of available oil volumes, as well as the continual postponement of the Kashagan field development launch eliminated the question of the country's participation in filling the Baku-Tbilisi-Ceyhan pipeline from the agenda.

## Azerbaijan Builds Up Gas Production

In the late 1990s, Azerbaijan made efforts to strengthen its position on the gas market. The production of associated natural gas was meant to increase along with the rise in oil production. However, even if the natural gas production volume was to increase, the opportunities for its export would be highly limited. The nearest export market in this case would be Turkey, and in order to re-enforce its position as a transit state, Azerbaijan supported the idea of constructing *the export TransCaspian gas pipeline* (TCGP) that would originate in Turkmenistan and run under the Caspian Sea, particularly since Ashghabad was suffering from isolation in communications and transportation, and was searching for new marketplaces for the gas it was producing in large quantities. In May 1998, Georgia declared its intention to join the construction of the TransCaspian gas pipeline.

The discovery of significant gas reserves in Azerbaijan at the Shah Deniz field changed Baku's stance on the issue of the TransCaspian project implementation. The Azerbaijani side began to lay plans in regard to constructing a pipeline for exporting its gas to Turkey.

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<sup>20</sup> *Panorama (Kazakhstan)*, 8 October, 2010.



The situation changed radically with the discovery of new reserves of natural gas instead of oil at the Shah Deniz field. The increase in gas production volume raised the issue of creating the infrastructure required for its transportation to outside markets, which was the reason behind Azerbaijan's heightened interest toward the layout of the *Baku-Tbilisi-Erzurum gas pipeline* project with a projected capacity of 16 bcm. Azerbaijan has entirely lost interest in the TransCaspian gas pipeline.

Construction of the Baku-Tbilisi-Erzurum gas pipeline began in 2001, when Azerbaijan and Georgia signed a corresponding agreement in Baku. By 2007 the gas pipeline was built, which allowed Azerbaijan to count on an increase in hydrocarbon deliveries to the West and bring its export to Russia down to a minimum<sup>21</sup>.

## Turkey's Role in Azerbaijan's Energy Policy

In the second decade of the 21st century, Azerbaijan adjusted its energy policy, departing from the univocal commitment to the Nabucco European pipeline project. In conjunction with Turkey, Azerbaijan proposed pipeline projects that were intended to ensure the entry of Azerbaijani gas to the European market<sup>22</sup>.

Baku's chief focus is on the implementation of the Southern Gas Corridor, which is supposed to provide a framework for the export of Azerbaijan's gas to the European market. The first phase of the Southern Gas Corridor includes the construction of a system consisting of the Trans Anatolian (TANAP) and Trans Adriatic (TAP) gas pipelines, which are supposed to be in operation by 2019. The Shah Deniz field is meant to become its resource base, and 16 bcm of its gas should be delivered to European countries. The volume of export to Turkey is expected to constitute 6 bcm, and export to the European market—10 bcm.

The above-mentioned projects corresponded to Baku's strategy on expanding its footprint on the European market following the discovery of new natural gas reserves at the Shah Deniz field. Azerbaijan has great expectations of increasing its export as this field is developed further<sup>23</sup>. In addition, the agreements between Azerbaijan and Turkey strengthen both countries' positions, making them a significant element of the European energy safety system.

## Conclusion

Azerbaijan's oil industry accounts for over a half of its budget revenues. The prosperity of practically every social stratum in the country depends on global oil price fluctuations. However, in the near future the role played by oil may become less significant, and chief attention will be drawn to gas, which is likely to become Azerbaijan's chief export product in the 2020s. This Caspian state's oil industry will remain one of the largest ones in the region, but will probably decrease its share in

<sup>21</sup> K.S. Stegen, J. Kuznir, "Outcomes and Strategies in the 'New Great Game': China and the Caspian States Emerge as Winners," *Journal of Eurasian Studies*, No. 6, 2015, pp. 91-106.

<sup>22</sup> *Evolutsia postsovetskogo prostranstva: proshloe, nastoiashchee, budushchee: khrestomatia*, RSMD, Moscow, 384 pp.

<sup>23</sup> "Ekonomicheskie problemy Azerbaidzhana," in: *Postsovetskie gosudarstva: 25 let nezavisimogo razvitiia*, Collection of articles, in two volumes, Vol. 2, ed. by A.B. Krylov, IMEMO RAN, Moscow, 2017, p. 29.

the country's economy as the largest fields become depleted. Secondary enhanced oil recovery technologies are applied at a number of giant fields, discovered and placed in operation by Soviet geologists in the 1970s-1980s, and they've already passed their peak of production. For example, the peak of production at Azeri-Chirag-Gunashli fell on 2014-2015. Although the project's shareholders intended to stabilize production in 2015-2020 at the level of 33-34 million tons of oil per year, a level of 30-31 million tons seems more realistic. Oil companies are actively developing the previously undeveloped parts of the fields. There's also work being undertaken in developing deposits beyond Azeri-Chirag-Gunashli. For example, production has been going on for several decades at a shallow area of Gunashli that was not included in the "contract of the century."

In recent years, oil production in Azerbaijan has been fluctuating in the range of 42-43 million tons. In 2013, the country produced 43.1 million tons of oil, and in 2015 the production amounted to 41.6 million tons.

There are fundamental problems behind the decrease in production volumes in Azerbaijan, problems whose roots are concealed in the late 1990s. Accordingly, gas will play an increasingly greater role in the country's energy complex. Gas production in Azerbaijan between 2006 and 2016 has tripled from 6 bcm to 19 bcm.

Implementation of new routes for natural gas delivery should provide Azerbaijan with an opportunity to increase export volumes. Thus, Baku has great expectations connected to the second phase of the Shah Deniz field development, located on the Caspian Sea shelf 70 km from Baku. This gas condensate field with recoverable gas reserves of 1.2 trillion cubic meters has been developed since 2006, and the production there reached a peak level of 10 bcm in 2015, during the first development phase.

The new round of development, referred to as Shah-Deniz 2, will increase the production on the field to 26 bcm. The main portion of the growth gain, 10 bcm, is intended for European delivery, while 6 bcm will be exported to Turkey under the provisions of the existing bilateral agreement.

Azerbaijan has aligned its energy interests with Turkey, which plays a significant role in ensuring the uninterrupted delivery of oil to Europe, and its weight will only grow after the new gas pipelines are put into operation. Since the Turkish segment of the TANAP gas pipeline will, according to the plan, be completed in 2018, Turkey will be the first to receive gas, while European consumers will begin receiving the Shah Deniz 2 gas somewhat later, in 2020.

Perhaps, Azerbaijan's Caspian shelf does not contain enough natural gas to provide competition to Russian export. On a scale of separate European countries, particularly the ones located in the south of Europe, Azerbaijani gas deliveries may play a positive role. Generally, however, Azerbaijani gas will not seriously influence the European gas market.

In any case, the volume of Azerbaijani natural gas will be sufficient for Baku to retain its leading role in the Caspian region. Possessing the required infrastructure and an advantageous geographical location half-way en route from the Caspian to the Black Sea, Azerbaijan possesses all the conditions necessary to strengthen its position as the principal exporter of Caspian hydrocarbon resources.