

sector, and expand the range of its partners. The latter, in turn, is a reflection of a growing conviction in Baku

that independence is not only about freedom of land, but is also about freedom of choice.

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The State Oil Company SOCAR: A Microcosm of Azerbaijani Development?

By Heidi Kjærnet, Oslo

Abstract

Baku has not shown signs of moving towards resource nationalism, but Azerbaijan’s national oil company SOCAR plays an important role in the country’s petroleum sector. In addition to being partner to the international oil companies present in Azerbaijan, the company is an actor in policy formation. Close ties between the government and the company ensure that SOCAR, in addition to being one of the biggest taxpayers in Azerbaijan, also carries out political and social tasks for the government. At the same time, commercial tasks are intertwined with petroleum policy and regulation, and the Azerbaijani national petroleum sector seems to be moving in a more opaque direction.

SOCAR as a Microcosm of Azerbaijan

Regimes pursuing resource nationalist policies generally make the national oil companies (NOCs) an important vehicle for increased control over the petroleum sector. Azerbaijan has not followed Russia and Kazakhstan’s example in curtailing the international oil companies’ presence in the country. Studying the national oil company SOCAR nevertheless provides interesting insights into the Azerbaijani regime. Viewed as a microcosm of the challenges that Azerbaijan itself is facing, SOCAR can shed light on the country’s prospects for modernization or stagnation.

Azerbaijani Petroleum Policy

Petroleum resources have been paramount in Azerbaijan’s economic and political development since independence. The significance of the international oil companies’ (IOCs) presence in Azerbaijan is marked particularly by two events: the signing of the so-called “Contract of the Century” with an international consortium to develop and produce oil from the Azeri-Chi-

rag-Guneshli fields in the Caspian Sea in 1994, and the construction of the Baku–Tbilisi–Ceyhan (BTC) pipeline transporting oil from Baku to Ceyhan in Turkey by a BP-led consortium, which ended the Russian monopoly on the transport of energy resources from the Caspian region. SOCAR was established in 1992 as a merger of Azerneft and Azneftkimiya, two companies with historical roots in the Azerbaijani Soviet Socialist Republic. The company is the national partner to the IOCs in all the production sharing agreements (PSAs) that exist between Azerbaijan and foreign partners. As such SOCAR has a 25 per cent stake in the BTC oil pipeline and in the South Caucasus Gas Pipeline (SCP), and it is partner to over 20 PSAs. Some of the PSAs have been abandoned due to unsatisfactory exploration results. SOCAR manages the production and sale of oil and gas from the old Soviet-era fields in Azerbaijan. These make up a very small share of the country’s total oil and gas production and exports, and SOCAR’s output has been declining by around 1 per cent a year. 80 per cent of the country’s

oil output in 2007 came from the Azerbaijani International Oil Consortium's (AIOC) fields.

The Azerbaijani leadership emphasizes the significance of the international presence in the petroleum sector, and has not displayed any signs of moving in the resource nationalist direction that Kazakhstan and Russia have. It is generally assumed that a mature extraction industry can lead to the kind of changes predicted by the obsolescing bargain literature and spur governments in resource-rich countries to renege on contracts in order to capture a larger share of revenues or gain more control of the petroleum sector. Since Azerbaijan's oil production, according to some forecasts, may peak as soon as 2011 or 2012, one could possibly expect Baku to make steps in a resource nationalist direction. However, apart from some very recent threats to reconsider its relationship with Washington in light of U.S. support for the Armenian-Turkish rapprochement, Azerbaijan's leadership has overall expressed a strong willingness to cooperate with the IOCs and even made the international presence of the IOCs an inseparable part of its foreign policy. Azerbaijan's ambitions for regional leadership in the South Caucasus also presuppose the support of international partners, thus making a resource nationalist turn unlikely.

Give and Take

Even if Azerbaijan does not make a move towards resource nationalism, SOCAR still has an important role to fill in the country's petroleum policy. As the national partner in all the PSAs in Azerbaijan, SOCAR is the spearhead of Azerbaijani interactions with the international oil industry. Since the signing of the first PSA in Azerbaijan, in which the company had a 10 per cent share, the company's share in subsequent PSAs has been increasing. In more recent PSAs, SOCAR's share is generally between 20 and 50 per cent. This could be a sign of increased financial ability and technological competence on the company's side coupled with the political will to strengthen the company's role in the Azerbaijani petroleum sector through increasing local content.

SOCAR's political and social obligations beyond petroleum production are perhaps less known. As one of the biggest taxpayers in Azerbaijan, its success is crucial to the country's continued economic growth. But SOCAR also takes on social responsibilities directly through large-scale programs focusing on building hospitals, schools, and creating recreational opportunities for various groups of beneficiaries. The list of beneficiaries of the government's social programmes and SOCAR's social work is strikingly similar. Typically, a

school or clinic that is built by SOCAR will be opened by President Ilham Aliyev under the auspices of the Heydar Aliyev Foundation (a foundation run by the current president's wife in the name of his father, the former president). This way, the lines between the company's and the government's tasks and roles are blurred, and the company helps create an image of the oil revenues being spent for the public good.

It is not uncommon for NOCs to take on non-commercial tasks like this. In the Azerbaijani case it appears to be part of SOCAR's political obligations towards the president, in a system where loyalty to the president is a precondition for economic activity. SOCAR's special role in the Azerbaijani petroleum sector is thus a matter of both give and take. There are limits, however, to how many hospitals and schools an efficient oil company can build. Estimates of SOCAR's performance are based on limited access to quantitative data on the company's performance (see the suggested reading section), but generally indicate that the company stands out even among underperforming NOCs as terribly inefficient. SOCAR, as many NOCs, operates according to competing logics: It needs to be commercially successful, and it needs to deliver on some specific social and political tasks. Employment policies can serve as an example of the company's challenges with regard to economic efficiency: whereas Russia's Gazprom produces 17,102 barrels of oil equivalents (BOE) per employee, SOCAR only produces 2,610. It has 70,000 employees and provides them with flats, preferential summer vouchers, kindergartens, and health care services in designated hospitals. Even though petroleum sector revenues make up 59 per cent of total revenues in Azerbaijan, this economic sector only creates a very limited number of jobs, and the unemployment rates in Azerbaijan are high. In a context where the government is seeking legitimacy through increased employment rates, SOCAR's employment policies could be an indication that the company is taking on social responsibilities to alleviate the pressure on government. It could however, also be the case that the size of the company is not a conscious strategy, but rather a result of its functioning like an expanding bureaucratic structure lacking strategies and control over its own employment practices. In any case, the high levels of employment are an indicator of the company's poor economic efficiency.

Close ties between the company and government is another common characteristic of government-NOC relations in post-Soviet states. President Ilham Aliyev came to office not only as the son of the former president, but as a former vice president of SOCAR. Formally, it is the Ministry of Industry and Energy, estab-

lished twelve years after SOCAR, which is tasked with supervising SOCAR's activities. In reality the ministry's role is severely limited by the PSAs, which have the status of law and regulate all aspects of the IOCs' presence in Azerbaijan as well as the consortia's activities from production through Corporate Social Responsibility (CSR) obligations, to taxation and local content. The PSAs, and SOCAR's strong position and close ties to the president, leave little room for the ministry to engage directly with the petroleum sector.

Over time, the conflict between commercial and non-commercial goals within SOCAR could stimulate competition between groups inside the company coupled with groups in government circles favouring reform to increase efficiency and others favouring the status quo. For now, the social work of SOCAR may be a sign of its political subservience to the president. However, the competition between commercial and other goals could change if forces within the company or government unite to promote reform of the company, or if the goals set for the company are altered altogether in a political effort to modernize it. For the time being, however, despite Azerbaijan's status as an implementing country under the Extractive Industries Transparency Initiative (EITI), SOCAR is moving in the complete opposite direction, concealing more information than before. For instance, in the annual report for 2008, which was published significantly later in 2009 than has been the case with previous annual reports, SOCAR did not reveal its revenues from the sale and export of oil and petroleum products, which have figured in earlier reports. Further, SOCAR does not have a board of directors. The company's presidents and vice-presidents are appointed by the president of Azerbaijan. A board could potentially separate political and commercial decisions and translate the political influence in a more transparent manner than today, but plans to establish one have not yet materialized.

SOCAR's Role in Petroleum Policy Formation

Historically, SOCAR has played a special role in Azerbaijani petroleum policy formation. Under the short-lived Popular Front government in 1992–1993, SOCAR was responsible for negotiations with foreign partners over the extraction of resources in the Caspian. There was a short intermission when Heydar Aliyev came to power and the company's seat at the negotiating table was given to one of his close allies, but SOCAR regained its role shortly after. SOCAR was at the time the only body in the newly-independent state that had the com-

petence to negotiate with international partners over oil production. To this day, the company has a dual role in the Azeri-Chirag-Guneshli contract, both as a company and as a government agency, strengthening the impression that commercial interests on the one hand, and policy formation and regulation on the other, are not dissociated in the Azerbaijani petroleum sector. SOCAR is currently negotiating with Turkish counterparts on the transport of Azerbaijani gas from the Shah Deniz field via Turkey to Europe. Transport of gas is an issue with significance beyond the field of energy, since the export routes of energy are an important part of foreign policy. Most likely, SOCAR's negotiating positions are decided in close cooperation with the president. Having a seat at the negotiating table is, however, an indicator of the company's strong position in Azerbaijan's petroleum policy formation.

Conclusion

There is a profound lack of separation of commercial and political tasks in the relationship between the Azerbaijani government and the Azerbaijani national oil company SOCAR. SOCAR has established itself as a strong actor in the sector, seemingly acting in close cooperation and agreement with the president, who keeps a close eye on the petroleum sector and has his trusted allies in the company's management.

Having been the sole body in the country with competence to deal with international partners in the oil business in the early 1990s, SOCAR has since been able to retain a strong role in Azerbaijani petroleum policy formation. This has resulted in a situation where the government body charged with oversight of the company, the Ministry of Industry and Energy, has neither the authority nor the political strength needed to control SOCAR. However strong the company's role in petroleum policy formation has been historically, it would nevertheless seem that SOCAR's special role in the petroleum sector is premised upon its subservience to Azerbaijani petroleum and foreign policy, as well as delivery of certain social goods. Hence, an emancipation of SOCAR does not appear imminent. Due to the potential competition between commercial and non-commercial goals set out for the company, we may, however, see a development where SOCAR, in pursuit of greater commercial efficiency, may need to cut back on its social and political obligations. For the time being however, SOCAR is not displaying any signs of imminent reform. Rather, the movement seems to be in a more opaque direction.

(Information about the author and further reading overleaf.)

About the Author

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Further reading

- The World Bank Group and the Center for Energy Economics/Bureau of Economic Geology (2008) “A Citizen’s Guide to National Oil Companies”, Washington DC/Austin, Texas: The World Bank.
- Victor, Nadejda Makarova (2007) “On Measuring the Performance of National Oil Companies (NOCs)”, Stanford, CA: Stanford University.



Oil and Gas Revenues Management in Azerbaijan: Crude Dependence and Its Consequences

By Kenan Aslanli, Baku

Abstract

Azerbaijan’s macroeconomic and fiscal indicators during the global economic crisis reflect the dependence of the Azeri economy on oil and gas. The addiction will continue to increase from year to year. The country’s rising oil dependence might upset macroeconomic and fiscal equilibriums, and intensify the risk of civil unrest among vulnerable social groups. Social repercussions are possible if oil and gas revenues are managed poorly or distributed unjustly.

Increased Oil and Gas Dependence in Azerbaijan’s Economy

At a time when Azerbaijan’s dependence on energy revenue is increasing, the government is spending money in non-transparent ways. Unfortunately, there is little societal oversight to check these tendencies.

Azerbaijan’s revenues from oil and gas are expected to total \$198 billion in net present value terms through 2024. This sum will flow from the annual growth of oil and gas extraction on the basis of the joint development of oil and gas deposits in the Azerbaijani sector of the Caspian Sea and higher prices in the world oil market. As the mission statement of the State Oil Fund of Azerbaijan Republic (SOFAZ), established in 1999, points out, part of the projected income will be sterilized in the domestic economy, while another part should be saved for future generations, and it will be invested in the inter-

national securities market. For this purpose, SOFAZ cooperates with the Reserve Assets Management Program (RAMP) of the World Bank, which has been in existence for more than 40 years. Today, the World Bank manages \$114 million of Azerbaijan’s money.

In 2009, the strategic currency reserves of the country increased by \$1.8 bn., and taking into consideration the assets of SOFAZ, totaled \$20 bn. Revenue obtained from foreign exchange assets management totaled \$430 million, of which \$287.7 million went for national foreign debt servicing. As a result, earnings obtained from assets management exceeded payments for loans by a factor of 1.5. But, at the same time, foreign trade turnover fell to approximately a third of previous levels and exports declined from \$47 billion (2008) to \$14 billion (2009). SOFAZ has been actively working to provide greater transparency and accountability leading to