

A State on the Rise?

*Azerbaijan as a New Regional
Leader in the South Caucasus*

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Abstract

This paper sheds light into the linkages between regional political leadership and energy policy. Looking at the role of Azerbaijan in the South Caucasus, it argues that a hydrocarbons producing and transit state can maximize its position within an energy transportation network to become a regional leader. It first demonstrates that Azerbaijan has benefitted from the attention towards the Caspian energy scene to get closer to the EU and the United States. The development of a Caspian energy transportation system has enabled the Azerbaijani state oil company, SOCAR, to secure its commercial position domestically and to expand regionally. This regional expansion, coupled with the rising importance of natural gas across the Caspian hydrocarbons system, has supported the rise of Azerbaijan as a regional political leader. This paper concludes that Azerbaijan's regional influence relies on SOCAR's business network, that energy is the country's preferred tool for exerting power and that its regional expansion helps Baku both to increase its revenues and to influence regional politics that may conflict with its vital interests.

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It is usually admitted among regional experts that there is no such thing as regional cooperation in the South Caucasus¹. Often, the three countries – Armenia, Azerbaijan, and Georgia – are depicted as simply too different from one another, culturally, ethnically and politically. Moreover, the conflicts between and within these states are defined as (potential) sources of tension, preventing any form of cooperation from developing. While this is true for Armenia and Azerbaijan (due to the Nagorno-Karabakh war), it does not seem to apply to relations between Azerbaijan and Georgia. Indeed, since the 1990s, the trade turnover between Baku and Tbilisi has risen year on year (around 28.9 % between July 2009 and July 2010 according to the Georgian National Statistics Service). Moreover, especially since the arrival to power of Ilham Aliyev in Azerbaijan and Mikheil Saakashvili in Georgia, political cooperation has continued to develop. In both cases, economic and political, Azerbaijan seems to be the key driver of this process. The rising Azerbaijani investments in Turkey confirm this tendency: Azerbaijan is turning into a regional economic leader in the South Caucasus, which helps it to promote its foreign political interests.

1 See for instance Minassian, Gaidz, "Caucase du Sud: les enjeux de la coopération régionale", *Politique étrangère*, 3, 715-731, 2002.

Following the oil boom of the early 20th century, Azerbaijan reappeared on the hydrocarbons map in the mid-1980s. A Production Sharing Agreement (PSA) for the main Azerbaijani oilfields – Azeri-Chirag-Guneshli (ACG) – was signed in Baku on 20 September 1994. This PSA also set up a consortium comprising of ten international and transnational oil companies² – the Azerbaijan International Operating Company (AIOC) – to explore and produce ACG oil volumes, then estimated at 3.5 billion barrels.³ In the meantime, Azerbaijan became a gas-producing country. In 1996, a PSA between Azerbaijan and six national and international oil companies was signed for the Shah Deniz field⁴. Azerbaijan quickly turned out to be an important gas producer, with the Shah Deniz reserves estimated at 1.2 trillion cubic meters.⁵

All these oil and gas resources are located in the landlocked Caspian Sea, and export routes were desperately needed. But at that time, the existing routes could be counted on the fingers of one hand. Regarding oil, one option

2 These companies were the U.S.-based Amoco, McDermott and Unocal, the U.K.-based BP and Ramco Energy, the Saudi Arabia-based Delta-Nimir, the Russia-based Lukoil, the Norway-based Statoil and the Turkey-based TPAO.

3 The ACG oilfields are now estimated to contain around 9.5 billion barrels.

4 These companies were BP, Statoil, TPAO, the Iran-based NICO, the Russia-Italy-based LukAgip, and the France-based Elf (now known as Total).

5 Two new fields yet to be drilled – Absheron and Shafag-Asiman – may increase the gas production of Azerbaijan in the next decade.

was to use the Baku-Novorossiysk pipeline, which transported Siberian oil to Baku refineries in the Soviet times. Another possibility was to rehabilitate the Baku-Supsa pipeline. Other routes, such as a swap system with Iran or a pipeline through Armenia, were also proposed. But all were rejected for political reasons: the United States strictly forbade its companies to deal with Iran, while the Armenian option collapsed due to the Nagorno-Karabakh conflict⁶. AIOC finally decided to set out two phases in the export process. The first one deals with the evacuation of early oil, i.e. small volumes (up to 120,000 barrels a day) from Chirag 1 platform, while the second concerns the study of a potential main export pipeline.

Two routes were finally chosen to transport the early oil: the Northern Route Export Pipeline (NREP), also known as the Baku-Novorossiysk pipeline, and the Western Route Export Pipeline (WREP), also known as the Baku-Supsa pipeline. It was then agreed to build a main export pipeline and, after long and difficult negotiations from 1997 to 2002⁷, the construction of the Baku-Tbilisi-Ceyhan (BTC) oil pipeline was

6 In early 1995, the Azerbaijani President Heydar Aliyev proposed to his Armenian counterpart that Azerbaijan transport its oil through a pipeline crossing Armenia in exchange for the withdrawal of Armenian troops from the occupied territories. In the absence of an answer from Armenia, this option was quickly discarded.

7 Lussac, Samuel, "The State as a (Oil) Company? The Political Economy of Azerbaijan", GARNET Working Paper, 74/10, 2010.

agreed. Another route – the Baku-Batumi railroad – is also now used to transport ACG oil. In 2010, these four export routes shipped approximately 45.2 million tons of oil⁸. After 2006, a new pipeline was opened along these oil routes. Known as the South Caucasus gas pipeline (SCP), it transports up to 8.8 billion cubic meters (bcm) of gas a year from Shah Deniz. In 2010, it shipped 4.9 bcm to Georgia and Turkey⁹. These five hydrocarbon routes are known as the East-West Energy Corridor, and their management entails cooperation between not only the three transit states (Azerbaijan, Georgia and Turkey) but also with and among the oil companies, including BP, Statoil and Total.¹⁰

These five routes are all part of the Caspian hydrocarbons transportation system (CHTS). Three route networks within this system need to be highlighted: the Azerbaijani oil and gas transportation networks and the Kazakhstani oil transportation network. Building these networks enables us to follow associations and connections between actors, such as the links between BP and SOCAR in relation to ACG oil transportation. They facilitate analysis of the interactions between the actors

8 BP, Business Update. 2010 Full Year Results. [PowerPoint Presentation online], 2011 (available : <http://www.bp.com/genericarticle.do?categoryId=9029616&contentId=7067613>; accessed on 18 April 2011).

9 Ibid.

10 In 2010, up to 17 oil companies were shipping oil or gas through the East-West Energy Corridor.

involved in the hydrocarbons transportation business. These networks are made up of different types of actors, who apply different tools. The different actors' strategies are of course based on their natures, but also on their means and ability to mobilize other actors within this network and to exert power over these actors. These various strategies may help in explaining the further development and shape of the CHTS, as well as the role played by Azerbaijan.

Using the case of the East-West Energy Corridor, this paper will demonstrate how a producing and transit state can maximize its position within a transportation system to become a regional leader. Thus, this research assumes that Azerbaijan plays a leading role within the CHTS, which is helping it to develop its economic and political influence in its neighborhood. The development of the CHTS in the 1990s offered Azerbaijan the opportunity to get closer to the EU and the United States. Baku has gradually taken over these networks, unifying the Azerbaijani energy market and benefitting from SOCAR's regional expansion. Finally, the shift of the CHTS from oil-dominated routes to gas-dominated ones has supported Azerbaijan's regional expansion, increasing its capacity to influence the policies being developed between its neighbors.

The Role of Azerbaijan within the CHTS

As a hydrocarbons-producing country and transit state, Azerbaijan holds a central position within the CHTS, which may help it to shape the network. The country would then be able to use its dominant position to promote its own interests and exert power over the other components in these networks.

Azerbaijan as a central actor in this system

Azerbaijan emerged as a central actor within the CHTS in the early 1990s. Its position first as an oil- and gas-producing country and then as a transit state helped it secure a strategic place in Caspian hydrocarbons development. As in any oil-producing country, every international oil company willing to invest in Azerbaijan had to go through the government and the state oil company, SOCAR. The political instability of the country¹¹ could have undermined its ability to negotiate with powerful international corporations such as Amoco or BP. But despite the series of changes in government during the early nineties, there has been reasonable continuity in the management of the negotiations for the production of Azerbaijani hydrocarbons. For instance, V. Alasgarov, principal assistant of

¹¹ From 1990 to 1994, the Azerbaijani leadership changed three times: Ayaz Mutalibov, then Abdulfaz Eltchibey and finally Heydar Aliyev.

the founding president of SOCAR, Sabit Bagirov, managed to keep his position despite the leadership transition in June 1993 when Heydar Aliyev came to power. Aliyev recognized Alasgarov's knowledge of oil contracting. This continuity helped Baku to maintain a clear and consistent line in negotiations with the ACG consortium.

This gave Azerbaijan further opportunity to promote its interests and to persuade the international oil corporations to accept its demands. Thus, the Russian oil company Lukoil gained a 10% share in ACG, even though it did not participate in any negotiations or discussions with Amoco or BP¹². This was due to President Aliyev's desire to have a Russian partner in ACG, in order to maintain good relations with Moscow.¹³ Lukoil president Vagit Alekperov¹⁴ took advantage of his relationships with Alasgarov and Aliyev to gain AIOC membership. Azerbaijan's position as an oil-producing country enabled it to develop a consistent energy policy and to secure strategic partners within the CHTS.

The ability to involve other actors within this system paved the way

12 Both companies were leading the negotiations with SOCAR on behalf of the eight other international oil companies.

13 In the days following the signature of the Contract of the Century, Moscow stated that such a deal was illegal until the status of the Caspian Sea was determined.

14 Vagit Alekperov is an Azerbaijani engineer who was trained at the Oil Rocks in Azerbaijan before being sent to Western Siberia to supervise oil developments there.

The only market available for Shah Deniz production was Turkey. Azerbaijan and Turkmenistan were thus in competition in terms of selling their gas and implementing gas pipelines.

for further developing the various networks, i.e. for shaping their composition and organization. Azerbaijan has been able to influence the choice of Azerbaijani oil and gas export routes. For instance, in 1999, a consortium made up of Bechtel Enterprises, General Electric and Shell proposed a pipeline – the Trans-Caspian – from Turkmenistan to Turkey through Azerbaijan and Georgia. Its objective was to deliver Turkmen gas to Turkey and then Europe. In the meantime, the gas field of Shah Deniz was officially discovered and both Azerbaijan and BP started to look for a gas market nearby and for export routes. The only market available for Shah Deniz production was Turkey. Azerbaijan and Turkmenistan were thus in competition in terms of selling their gas and implementing gas pipelines. Ultimately, Baku refused to allow Turkmen gas to be transported through Azerbaijani territory, and Turkmenistan was pushed out of the CHTS.¹⁵ The SCP was then implemented to the detriment of the Trans-Caspian. Azerbaijan thus

15 The enmity between Heydar Aliyev and the Turkmen President Sapamurat Niyazov also contributed to the collapse of the Trans-Caspian project.

demonstrated its ability to include or exclude actors according to its national interests.

Inscribing different meanings in the CHTS

In spite of its leading role within the CHTS, Azerbaijan's role in Caspian oil and gas development was somewhat limited until the mid-2000s, i.e. before the influx of oil money to the state budget. Firstly, even if Baku knew the structure of its seabed, it lacked the financial and technological capabilities to develop its own hydrocarbons resources. In the late 1980s, Azerbaijani geologists produced Russian-language reports on the Caspian subsea, underlining the differences between the proto Volga delta and the lower Kura basin. The former comprises the ACG oilfields and the Shah Deniz gas fields while the reservoirs in the latter are contaminated with mud. But Azerbaijan was unable to develop its fields due to a lack of financial capacity. The collapse of the Soviet Union and the Nagorno-Karabakh war dramatically affected the state budget, to such an extent that AIOC had to pay for SOCAR's 10% share in ACG.¹⁶ Secondly, BP took charge of the implementation of the BTC pipeline to export most

¹⁶ In the *Contract of the Century*, SOCAR had a 20% share in ACG. However, as it was unable to pay for it, it decided to sell half of it to Exxon and TPAO in April 1995. Both companies bought it at a very high price (around 173 million dollars) in order to help SOCAR to pay AIOC. Meanwhile, the latter gave its 10% share in ACG at a very competitive price so that the Azerbaijani firm could afford it.

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of the Azerbaijani oil, indicating Baku's inability to build an oil transportation infrastructure system in accordance with international standards. The London-based firm set up the rules for the cooperation between the three transit states: Azerbaijan, Georgia and Turkey. Even if SOCAR was chairing the negotiations with the latter, BP was drafting the legal documents (mostly the host government agreements and the intergovernmental one). Thus even if Baku was able to frame the hydrocarbons transportation routes and to involve new actors within the CHTS, its role was still limited by its lack of financial and technological capabilities.

This forced Baku to share its leadership within the CHTS with BP¹⁷. This co-leadership shaped not only this system but also the 'inscriptions' Azerbaijan placed within it. Inscriptions are here understood as the meaning that an actor gives to some parts of a network. Being unable to play an active role within some parts of the CHTS, Baku decided to input different inscriptions. The Azerbaijani gas transportation network and a part

¹⁷ As the sole operator of ACG, Shah Deniz, and the BTC and the SCP pipelines, BP holds a key position within the CHTS and has been able to frame the different networks as well as to include or exclude actors.

of the Azerbaijani oil transportation network were dedicated to the promotion of Azerbaijani foreign policy. This network and this sub-network deal mainly with pipelines transportation. Because Baku's role within these networks was limited to the promotion of its preferred routes, Azerbaijan exclusively defined the Azerbaijani oil transportation network as a means to obtain financial and political support from external powers such as the EU and the United States and from international financial institutions like the World Bank. These pipelines, and the close international scrutiny they attracted, were supposed to help Baku attract financial aid, gaining legitimacy within the international community and getting at least neutrality, or support, in the Nagorno-Karabakh war¹⁸.

Therefore, Baku's weakness within the CHTS shaped not only this system but also the inscriptions it put in place. Still holding a strategic position, the financial situation of the country encouraged Azerbaijan to hold a relatively passive position within the CHTS, treating its pipelines components exclusively as tools of foreign policy directed at extra-regional powers.

¹⁸ For instance, Baku advocated its strategic position on the Caspian energy scene in front of the United States to obtain the removal of the Section 907 of the 1992 Freedom Support Act that prevents Washington from providing assistance to Azerbaijan.

Setting up the Basis for a Proactive External Energy Policy

When he succeeded his father as president of Azerbaijan in 2003, Ilham Aliyev faced a disorganized energy sector. He decided to rationalize and unify it, aiding the further consolidation of SOCAR in the Azerbaijani energy market. This supported the regional expansion of the energy market, building further links with Georgia and Turkey.

Unifying the domestic energy market to the benefit of SOCAR

In the 1990s, the Azerbaijani energy sector was poorly organized. The Azerbaijani oil business was divided into two parts: the first one was dominated by AIOC while the second one involved a large number of actors who were sometimes in competition with one another. Such divisions further complicated the Azerbaijani energy sector: to sum up, Azersun Holding handled the Baku refineries,

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SOCAR dealt with the onshore production, AzerTrans, MEPF and QavqazTransServis managed rail transportation of oil and, after 2001, the Ministry of Fuel and Energy was supposed to supervise them all. When

he became president of Azerbaijan in 2003, Ilham Aliyev inherited this messy arrangement. While the AIOC-dominated part was effective and brought money to the state budget, the other part was largely ineffective, benefitting the companies who were managing it but not the state.

To bring greater consistency to Azerbaijani energy policy, Aliyev progressively implemented a spoils system. Hence he decided to appoint a set of reliable people to manage the energy sector according to the state's interests, rather than the companies'. Since 2005, all the people in key positions in the energy sector have been replaced by a young generation of oilmen. Firstly, the president of SOCAR, Natig Aliyev, became the new minister of Industry and Energy and was replaced by Rovnag Abdullayev. Secondly, Heydar Aliyev's key energy advisor, V. Alasgarov, was appointed deputy speaker of the Parliament and replaced by Elshad Nasirov, who is now vice-president of SOCAR. The transfer of Azerigaz and Azerkimya to the authority of SOCAR, in 2009 and 2010 respectively, finalized the restructuring of the Azerbaijani energy sector. In the space of around four years, Ilham Aliyev, senior vice-president of SOCAR in the 1990s, centralized all oil and gas business. He developed a more coherent and effective system, over which the state can exert clear control. The unification of the energy market

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paved the way for the implementation of a strong state oil company that can hold a crucial role within the CHTS.

Indeed, SOCAR has reinforced its position at the core of the Azerbaijani energy landscape. Firstly, it took advantage of the energy environment in the early 2000s in Azerbaijan. At that time, Baku ended its policy of dedicating all oil revenues to covering state budget deficits. A proportion was thus available for SOCAR's business expansion. Moreover, due to the successive discoveries of non-commercial reserves or worse, dry holes, foreign companies have found Azerbaijan less attractive. This situation opened a window of opportunity for SOCAR's development. The Azerbaijani oil company started to develop the national assets in which foreign companies had no interest¹⁹. SOCAR chose to focus on the exploitation of these reserves, even if they contained only small volumes of oil²⁰. It now produces 180 000 barrels of oil a day from these fields.²¹ Thanks to these

¹⁹ The only oil companies that still look at Azerbaijani onshore reserves are emerging ones such as the Chinese CNPC or the Indian ONGC.

²⁰ Of the 56 oil and gas fields that SOCAR exploits, 38 are located onshore and 18 are offshore.

²¹ SOCAR also receives 75 000 barrels a day from its share in ACG. This data is from IHS Global Insight.

changes, SOCAR increased its cash flow and increased its involvement in the production of Azerbaijani oil reserves.

The regional expansion of SOCAR

Once it reinforced its position domestically, SOCAR was able to expand regionally, especially in Georgia and Turkey. This expansion is based on two trends. First of all, SOCAR has consolidated its position in the regional oil business. SOCAR is involved upstream because it has shares in ACG and owns oil reserves in Azerbaijan. It is also active midstream, as a member of the BTC consortium and a shareholder in CrossCaspian²². In this area, SOCAR's competitor is Baghlan Trading, particularly with regard to the transportation of Turkmen oil. It is involved downstream because it owns the Kulevi oil terminal. It also bought the Turkish petrochemical company PETKIM in 2008²³. In order to be a flagship firm and to take over the Azerbaijani oil transportation network, SOCAR must control every part of it. For the moment, it has commercial relationships with the key supplier, AIOC. But as a member of the joint management committee,

22 According to its own numbers, CrossCaspian would transport 90% of the oil products going from the South Caspian to the Black Sea. Its shareholders are AzTransRail (33%), QavqazTransServis (33%) and SOCAR (34%).

23 In partnership with Turcas, SOCAR acquired a 51% stake in PETKIM Turkish government in 2008 (the other stakeholder is the Turkish company Turcas). PETKIM owns more than 14 refineries in Turkey. This should enable SOCAR to refine or transform oil products and then sell them on the Turkish and European markets.

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it has detailed insights into the strategy of this key supplier. Given that the rest of the Azerbaijani oil comes from SOCAR-owned fields, the Azerbaijani oil company more or less controls this part of the network. On the consumer side, SOCAR owns two of the largest assets in the downstream part of the Azerbaijani oil transportation network: the Kulevi oil terminal and PETKIM, though this part of the network is less important in SOCAR's strategy. Every company with shares in ACG sells its oil to the highest bidder in Ceyhan. SOCAR cannot change this system and has no interest in doing so, as long as some oil goes to Kulevi. This progressive takeover of the Azerbaijani oil transportation network enables SOCAR to bolster its position in both Georgia and Turkey.

SOCAR is also diversifying its activity within the Black Sea energy market in order to gain a stronger position. To implement this strategy, SOCAR follows two trajectories. First, in order to become a major state oil company in the Black Sea energy market, it has to be active all along the energy chain, from the production business to the refining one. Second, it benefits from the good interpersonal

relations between the Azerbaijan and Georgian leadership, in order to increasing its activity in Georgia. The 1990s cooperation between Baku and Tbilisi was only based on pragmatic interests; Heydar Aliyev and Edward Shevardnadze both considered the WREP to be the most effective way to build closer ties with Europe and the United States. One would have expected this political-economic cooperation to fade, especially after the Russian-Georgian war in 2008²⁴. However, both Ilham Aliyev and Mikheil Saakashvili quickly saw that to serve mutual national interests, their countries would have to continue to cooperate. Georgia was eager to reduce Russia's influence in the energy sector as well as to attract foreign investment. In the meantime, SOCAR was rapidly developing and looking for investment opportunities abroad. Such cooperation was reinforced following 2008, Azerbaijan being one of the few countries that was not afraid to continue investing in Georgia²⁵. SOCAR Energy Georgia emerged in 2006 from this convergence of interests and has since become larger and larger. It progressively took over the Georgian gas market and now supplies around 70% of Georgian gas

²⁴ The Azerbaijani oil exports through Georgia were stopped for one month, due to the war and the explosion of a landmine on the Baku-Batumi railroad in late August 2010.

²⁵ During the Russian-Georgian war, Kazakhstan for instance announced its wish to decrease its investments in Georgia. However, such a trend has not materialized; the Kazakhstani oil company KazMunaiGas still owns the Batumi oil terminal, for example.

imports, and has become a key partner of Tbilisi²⁶. SOCAR is turning into a leader within the CHTS as a whole.

SOCAR's increased investment in Georgia does not only reflect further economic cooperation with Azerbaijan; it also sheds light on the reorientation of Baku's regional policy, with energy emerging as a tool to get closer to its neighbor as well as to external powers such as the EU.

Azerbaijan as a Rising Regional Leader in the South Caucasus

SOCAR's increasing involvement in Georgia opened the door for Baku's more active role within the CHTS. While energy and politics are more and more intertwined not only in Azerbaijan but also across the world (Helm 2007; Kjaernet 2009), the Azerbaijani leadership perceived this system as a tool to advance its political interests and to influence regional politics, as demonstrated by the case of the Turkish-Armenian *rapprochement*.

Gas as a new policy tool

In Azerbaijan, energy has key ramifications within the political and social spheres. It has, for instance, significantly shaped cooperation between Azerbaijan, Georgia and Turkey since the mid-1990s. It is a very flexible commodity: it can

²⁶ Since 2006, SOCAR has invested around 470 million dollars in Georgia and is the largest taxpayer there.

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be shipped by boat, truck, rail and so on, and does not necessarily require long-standing transportation infrastructures. The relationship between Ankara, Baku and Tbilisi that emerged from the construction of the BTC pipeline and the WREP reflects this. Oil has generated flexible and unstable relationships between these three countries. If their links were printed in a series of energy agreements²⁷, the alignment could still shift, as the Russian-Georgian war proved in 2008, when the BTC pipeline was shut down²⁸ and AIOC stated that it was not willing to send its oil through a country at war. Baku did not hesitate to reroute its oil exports through the NREP, which benefits precisely the country with which Tbilisi was at war. Gas is now progressively replacing oil as the key energy source. It is at the heart of future EU energy supply due to its flexibility in use and low carbon emissions. However, gas is a less flexible commodity to ship than oil. There are only three ways to transport gas: to compress it, to liquefy it or to send it through pipelines. Therefore,

27 The most important of these are (i) the intergovernmental agreement on the BTC pipeline signed in Istanbul in November 1999, and (ii) the trilateral Protocol relating to the security of the East-West Energy Corridor signed in Baku on July 23, 2003.

28 On August 5, 2008, a portion of the BTC pipeline exploded in the Erzincan province in Turkey after an attack by the Kurdish terrorist movement PKK.

the development of the Azerbaijani gas transportation network following the start of the Shah Deniz phase II production²⁹ may build further connections between Ankara, Tbilisi and Baku, producing a more stable type of cooperation between them. Baku with its key position in the CHTS as a whole may benefit from this transformation, and the opportunity to develop its position as a regional leader in the South Caucasus.

The links between energy and politics are deeply rooted in Azerbaijan. For instance, former president Abulfaz Elchibey created SOCAR in September 1992 on the basis of the former Soviet company Azerneft. He appointed as the head of the new firm his personal counselor on energy issues, Sabit Bagirov. Members of the ruling party, the Popular Front, dominated SOCAR at that point. They knew that hydrocarbons resources were the country's strongest, not to say unique, asset on the international playing field. When he came to power, Heydar Aliyev maintained this policy, selling shares in ACG to companies according to the price they were offering and to their geographic location. For instance, he refused to sell the 10% share of SOCAR to the French company Total, preferring a U.S. firm (Exxon) and a Turkish one (TPAO). However, such entanglement was rather limited.

29 The second phase of the production of Shah Deniz will start in 2016 and is projected to produce around 17 bcm per year.

Indeed, despite the relationship between energy and politics, Aliyev created a small and business-oriented decision-making structure comprised of only three other people: the president of SOCAR Natig Aliyev, the head of the foreign investment department V. Alasgarov and the vice-president of SOCAR Ilham Aliyev. The first two dealt with the technical issues while the third forged the link between SOCAR and the Azerbaijani presidency. The Azerbaijani president then took the decision in the last instance without being too much involved in the technical matters. Therefore, energy policy was led on a commercial as well political basis. The former President of Azerbaijan simply ensured that the commercial decisions endorsed by this team fitted with the country's foreign policy. This link between energy and politics has increased since the arrival to power of Ilham Aliyev, who, as a former senior vice-president at SOCAR, has great interest in and excellent knowledge of energy issues. Hence, it is not surprising that Azerbaijani gas has been used as a political tool to influence Turkey with regard to the Turkish-Armenian *rapprochement*.

A case study: how Azerbaijan has undermined the Turkish-Armenian rapprochement

The Turkish-Armenian *rapprochement* started with what has been termed "football diplomacy"³⁰. Ne-

30 On 6 September 2008, the Turkish President Abdullah Gül

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gotiations between Ankara and Yerevan continued, focusing on the opening of the Turkish-Armenian border and on the recognition of the 1915 Armenian genocide in Turkey³¹. These discussions led to the adoption of a roadmap in April 2009 and then to the signing of two protocols on the establishment and the development of diplomatic relations between Armenia and Turkey (10 October 2009, Zurich). Baku considered this diplomatic move contrary to its key national interests, especially regarding the resolution of the Nagorno-Karabakh conflict. Indeed, Azerbaijan has little political leverage to put pressure on Armenia and it feels that the opening of the Turkish-Armenian border could undermine its policy on the Nagorno-Karabakh issue. Therefore, having repeatedly expressed concern about this *rapprochement*, Azerbaijan decided to increase pressure on Turkey to prevent it from ratifying the Zurich protocols.

In April 2008, as laid out by the

paid an official visit to his Armenian counterpart for the World Cup qualification game Armenia-Turkey in Yerevan.

31 Turkey closed its border with Armenia in 1993 to express its support for Azerbaijan in the Nagorno-Karabakh conflict.

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contract for the Shah Deniz phase I gas, Azerbaijan and Turkey started renegotiating the purchasing gas price. On the Azerbaijani side, the technical operator – BP – or the former commercial operator – Statoil – of the Shah Deniz field should have taken the lead in these negotiations. However, advocating its regional expansion, SOCAR strongly pushed to act as the chief negotiator on this issue. Despite the reluctance of some companies in the Shah Deniz consortium, this request was accepted, mostly to avoid further commercial negotiations with Baku. Then, SOCAR decided to link the sale of the gas from Shah Deniz phase I to the sale of the gas from Shah Deniz phase II, and to raise the issue of transit through Turkey. Once again, members of the Shah Deniz consortium did not welcome such a decision but did not dare oppose it. Already a leader within the Azerbaijani oil transportation network, SOCAR also consolidated its central position within the Azerbaijani gas transportation network.

Baku has used its central position within the CHTS to obtain leverage over Turkey regarding the Turkish-Armenian dialogue. The link between gas negotiations and this issue was demonstrated in December 2009 when the Turkish Ministry of Energy asked BOTAS to make SOCAR an offer “they could not refuse”, as it was described by a BOTAS official. The Turkish company was reluctant to do so because such proposal was considered to put the financial state of the company at risk if it was accepted. However, due to pressure from the ministry, the offer was finally made. But SOCAR rejected it, saying that it was not interested in reaching a deal yet. This refusal surprised and disappointed BOTAS³², which then decided to put a hold on the negotiations. This proposal, though commercially advantageous according to Azerbaijani officials, could not be accepted because of the progress of the Turkish-Armenian dialogue. Ankara understood that it could not conclude a gas deal, which was considered essential to the Turkish economy as long as the Turkish-Armenian *rapprochement* was continuing. Three gas agreements were finally signed in Istanbul in June 2010. But these agreements are primarily political, and BOTAS and SOCAR still need to address the

32 Strong enmity between BOTAS and SOCAR negotiators emerged as a result of Azerbaijan's refusal. The Turks started complaining about the way SOCAR negotiated, notably about the refusal of the main negotiator to discuss in Turkish (he preferred to speak in English, considered the international working language).

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technical issues related to the sale and the transit of Azerbaijani gas in and through Turkey³³. These agreements shed light into the wish of both parties to improve their relations. The failure of the Turkish-Armenian *rapprochement* in April 2010 surely contributed to this rapid progress in the gas negotiations³⁴.

Thus Baku has made use of its ongoing gas discussions with Turkey to undermine the *rapprochement* between Ankara and Yerevan. This strategy has been successful for Baku, the latter being on standby now, while gas negotiations between BOTAS and SOCAR continue. The link between energy and foreign policy in Azerbaijan has shaped the CHTS. SOCAR is now at the heart of the CHTS and Baku is taking advantage of this favorable position in order to increase its investments in Georgia and Turkey, and to influence regional politics, especially in relation to the Nagorno-Karabakh conflict.

33 According to SOCAR, the gas transit agreement between Azerbaijan and Turkey will be signed in late September 2011.

34 Lussac, Samuel, "A Deal at Last: A Bright Future for Azerbaijani Gas in Europe?", *CACI Analyst*, 28 April 2010 (available: <http://www.cacianalyst.org/?q=node/5317/print>; accessed on: 28 April 2010).

Conclusion

The analysis of Azerbaijan's role within the CHTS illuminates a number of issues. Firstly, Azerbaijan has changed greatly since the 1990s. Initially in a fairly weak position, it has become a rich and powerful state that is managed as a company. Such a change has brought more coherence to national energy policy and has forged further ties between hydrocarbons development and foreign policy. Secondly, the construction of a coherent energy strategy has helped SOCAR to become a key actor within the CHTS. It has gone from being a negotiating partner for international oil and gas companies to being a leading firm that is setting the agenda and leading discussions with actors willing to be involved in the CHTS, such as the Nabucco consortium. Thirdly, the use of the energy argument to attract European and U.S. support over the Nagorno-Karabakh conflict has been largely unproductive, despite the lifting of Section 907 in 2002³⁵. This limited success led to a reorientation of Azerbaijani diplomacy from extra-regional powers to neighbors such as Georgia and Turkey. Fourthly, Azerbaijan has taken advantage of the rise of gas as the world's predominant hydrocarbon commodity to increase its investments in Georgia and in Turkey. This has helped SOCAR to take over the Georgian gas market

35 Shaffer, Brenda, "Caspian Energy Phase II: Beyond 2005", *Energy Policy*, 28, 7209-7215, 2010.

and to play an increasing role within the Turkish market. Lastly, this strategy helped Azerbaijan gain further power over both Ankara and Tbilisi, giving it the capacity to influence their respective foreign policies. The undermining of the Turkish-Armenian *rapprochement* demonstrates the success of this strategy.

Therefore, Azerbaijan's increasing role within the CHTS has contributed to its rising regional influence. This new regional leadership has three different features. Firstly, it takes advantage of the connections within SOCAR's business network to expand its influence over the region. Secondly, energy is its preferred tool to exert its power over both the CHTS and the agents operating within this system. Finally, its regional strategy is predominantly twofold: to increase its revenues from the control of various economic assets in the neighborhood and to influence regional politics that may conflict with its vital interests.