Black Gold or the Devil's Curse? Oil and Networks in Azerbaijan*

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검은 황금인가 악마의 저주인가? 아제르바이잔의 석유와 연줄망*

이 채 문**

Abstract : A chronic depression in the Korean economy, which depends mostly on imported oil, has been attributed partly to rising crude oil prices recently. Against the backdrop of these realities in Korea, Azerbaijan in the Caspian region, with vast oil and gas deposits, has been greeted enviously by some Koreans. Many transition economies, especially on the Caspian region trumpeted by the oil boom, however, are rich in natural resources, but the benefits of those resources are appropriated by the local elite in collusion with foreign companies. Azerbaijan, in particular, is dominated by a series of internal and external patronage networks. Foreign capital nourishes those networks surrounding President Aliev. Thus, the case of Azerbaijan shows that resource rents in the transition economies sometimes do not help in improving the living conditions of ordinary people. Rather rich resource rents turn out to be a major impediment to the emerging development of the transition economy, lessening the incentives to reform in the country. The result was the possibility of the so-called Dutch Disease, in which disproportionate growth in a certain energy sector tends to crowd out investment in other sectors of the economy.
Key Words : Azerbaijan, oil, network, PSA

요약 : 주로 수입원유에 의존하는 한국경제의 만성적 불황은 최근 급등하고 있는 수입 원유가에 기인하는 바가 상당히 크다. 이러한 한국의 현실을 감안할 때 풍부한 유전과 가스전을 보유하고 있는 카스피해 연안의 아제르바이잔은 일부 한국인들로부터 선망의 대상이 되고 있다. 그러나 많은 이행경제체제 국가들, 특히 아제르바이잔을 포함한 카스피해 지역에서 석유 붐을 타고 있는 것으로 알려진 상당수 국가들이 천연자원은 풍부하지만, 이러한 자원의 혜택이 외국자본과 결탁한 국가의 엘리트에 의해 유용되고 있는 것이 현실이다. 특히 아제르바이잔은 내부적 연줄망과 외부적 연줄망에 의해 지배되고 있다. 이러한 과정에서 외국의 자본은 아제르바이잔의 알리예프 대통령과 관련된 이러한 사적인 연줄망을 더욱 강화해 주는 역할을 하고 있다. 따라서 아제르바이잔의 경우, 풍부한 부존자원으로 인한 국가수입이 일반국민들의 생활향상에는 도움이 되지 못하고 있는 것이다. 오히려 이러한 부존자원으로 인한 증대되는 수입은 개혁의 유인을 감소시키면서, 에너지 분야의 과도한 성장으로 인해 여타 경제 부문에 대한 투자를 밀어냄으로써 이행경제체제의 발전에 장애가 되는 소위 '네덜란드병'을 발생시킬 가능성까지 야기하고 있다.
주요어 : 아제르바이잔, 석유, 연줄망, 생산물분배법

1. Introduction

Recently the Korean economy, which depends mostly on imported energy sources, has been in an economic slump partly due to rising crude oil prices hovering around $60 to $70 per barrel. A sharp increase in the price of oil threatens the Korean people with a surge in commodity prices and an ensuing fear of inflation. When citizens heard the news that national troops along the demarcation line with North Korea were asked to cut down on the number of field military maneuvers to save on fuel, this was received with mixed feelings (AsiaNews, 2004.10.27).

Against the backdrop of these realities in Korea, Azerbaijan in the Caspian region, with vast oil and gas deposits, represents a subject of enormous interest in and around the country.

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Azerbaijan, for instance, has been greeted in Korea with such grandiose compliments as "the point of the most strategic importance in the 21st century in terms of petroleum development," "the country into which massive foreign capital around the world is flowing," "one of the nations along the Caspian littoral with 233 billion barrels that can be comparable to Saudi Arabia with 261 billion barrels in terms of potential oil reserves."[1] In addition, the country in the Caspian region was also described as "… on the list of the rich oil-producing countries by means of exploration of black gold," or "a country dreaming of becoming the second Kuwait," in a Korean newspaper (Joongang Daily, 2000.1.6).

Internationally, such extravagant rhetoric regarding the country is also common. The word 'Azerbaijan' always reminds us of the following descriptions: oil-rush, "United Nations of oil," and "the Former Soviet Union's 'showcase' for the art of doing business" (Goldberg, 1998, 57). According to Alec Rasizade, an internationally known expert on Azerbaijan, however, it is Western analysts and newsmen who created the stereotype that Azerbaijan is an "energy-rich former Soviet republic on the Caspian Sea" (Rasizade, 2003, 358).

Thus when the construction of the $3 billion Baku-Tbilisi-Ceyhan (BTC) pipeline was inaugurated in 1992 or when the $7.4 billion "Deal of the Century," which involves the development of the Azeri, Chirag and Gunashli (ACG) offshore fields, was signed in 1994 at the extravagant ceremony between Azerbaijan and 11 international companies, most of the Western newspapers reported that the oil-boom in the country seemed to be right around the corner.

The gloomy realities of the ordinary people in Azerbaijan, however, are completely ignored, covered with the grandiose prospect of the Caspian oil-boom pledging billions of dollars in foreign investment. There are many signs that the country goes backward rather than forward.[2] According to the World Bank, 78% of people in the 'oil-rich' Azerbaijan eke out a scanty livelihood on less than $2 a day (World Bank, 2001, 36). Millions of Azerbaijanis moved out of the country even after the ostentatious declaration of the "Deal of the Century" in 1994. Why are power shortages commonplace events in the "oil-rich" Azerbaijan? What is worse, one-third of school-age children, who are so busy helping their parents picking up a scanty livelihood, are not attending their schools (Rasizade, 2004b, 145).

The goal of this paper is to show how the dismal phenomena above are taking place in 'oil-rich' Azerbaijan. Specifically, this study tries to show how the corruption process, which has led to the hardships of the average people, has been unfolding in the country on the Caspian Sea. It is argued that internal and external patronage networks are mainly responsible for the corruption in Azerbaijan. The internal network involves extensive connections among the President, his family members, and his inner circle, while the external network is oiled by a close alliance between the President and foreign capital in the course of investing in the Azeri oil sector.

Section Two of this paper describes the background in which the Azeri government has made an all-out effort to focus on oil. Section Three provides us with the process of the internal and external patronage networks centered around the ruling elite, in addition to the explanation of the Production Sharing Agreements (PSA) as a means of co-prosperity between foreign capitals and the authoritarian regime. The last section is devoted to discussion about the reason why Azeri oil is becoming the devil's curse rather than 'black gold'.

2. Political Economy of Oil Development in Azerbaijan

Azerbaijan has been famous for its enormous untapped oil and gas reserves since it became independent in 1991. Many foreign investors have rushed to the country in the Caspian Sea basin with huge amounts of foreign capital. Between 1995 and 2001, for instance, $4.1 billion of foreign capital have been invested in the energy sector in the country. Thus, crude oil and oil-related products account for more than 70 percent of all Azerbaijani exports and about 50 percent of budget revenues, according to a report published in 2004 (U.S. Department of Energy, 2004). Oil production in the country averaged 327,000 barrels per day (bbl/d) in 2003, which is half of the OPEC member Qatar. In 2010, however, production is estimated to reach between 0.79 and 1.14 million barrels per day, which is comparable to or even exceeding Qatar.[3]

Here we briefly need to look at the current situation of international oil contracts in Azerbaijan. Azerbaijan's old oil fields cultivated during the Soviet era remain in poor condition,

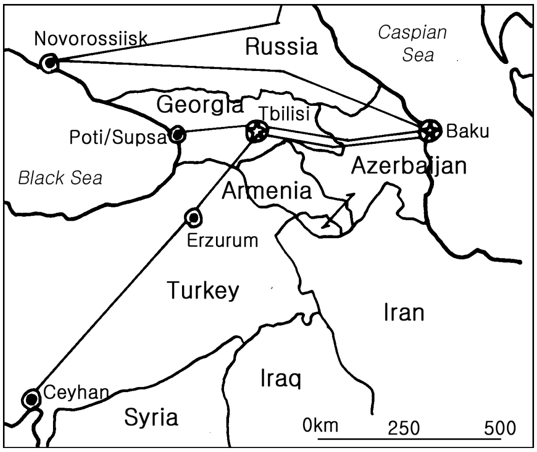
Source: U.S. Department of Energy, Energy Information Administration, Country Analysis Briefs: Azerbaijan, September 2004 [http:www.eia.doe.gov/emeu/cabs/azerbjan.html]

Figure 1. Map of Azerbaijan

but increasing foreign capital after the country's independence in 1991, revived large-scale oil development.

So far, more than 20 major international oil contracts[4] have been signed between 30 foreign energy companies from 15 nations and the SOCAR (State Oil Company of Azerbaijan Republic). The SOCAR is responsible for all exploration and development related with oil and gas in the country. One of the largest consortia is the AIOC (Azerbaijan International Operating Company). The AIOC, whose partners are BP, Unocal, SOCAR, Inpex, Statoil, ExxonMobil, TPAO, Devon Energy, Itochu, Delta/Hess, operates offshore Azeri, Chirag, and the deep water Gunashli (ACG) mega-structure. The ACG, which is called a super-giant oil field for its estimated proven crude oil reserves of 5.4 billion barrels, produced 144,000 barrels per day (bbl/day) in June 2004, approximately half of the total oil production in the country. The ACG introduced the "second Caspian oil rush" of the international major oil companies a century after the first one in the late 1800s.

Meanwhile, oil exports from Azerbaijan are being made through two pipelines: the Baku-Novorossiisk pipeline (northern route) and the Baku-Poti/Supsa pipeline (western route). The so-called "early oil" from the ACG (Azeri-Chirag-Guneshli) field in the Azerbaijan sector of the Caspian Sea is exported through the western route, while the northern route transmits the Azeri oil to the Georgian port of Supsa on the Black Sea. Next, the Baku-Tbilisi-Ceyhan (BTC) pipeline, which extends 1,768 km from Baku via Tbilisi in Georgia to Ceyhan in Turkey, was recently constructed and it is being filled up with crude oil at the Sangachal terminal near Baku starting from May 25, 2005. The BTC pipeline, one of the most complicated construction projects, was constructed with the participation of 11 consortium partners and three countries



Source: Adapted from *The Economist*, Oct. 7, 2002, p.5

Figure 2. Pipeline Routes around Azerbaijan

(BBC RUSSIAN.com, 2003, 10. 28).[5)]

The pipeline is expected to carry its first oil later in 2005 with a capacity of 1 million barrels a day. Although there have been many thorny issues with the pipeline in terms of international politics, its financing of the $2.9 billion pricetag and environmental aspects, Azerbaijani support for the project has been firm.

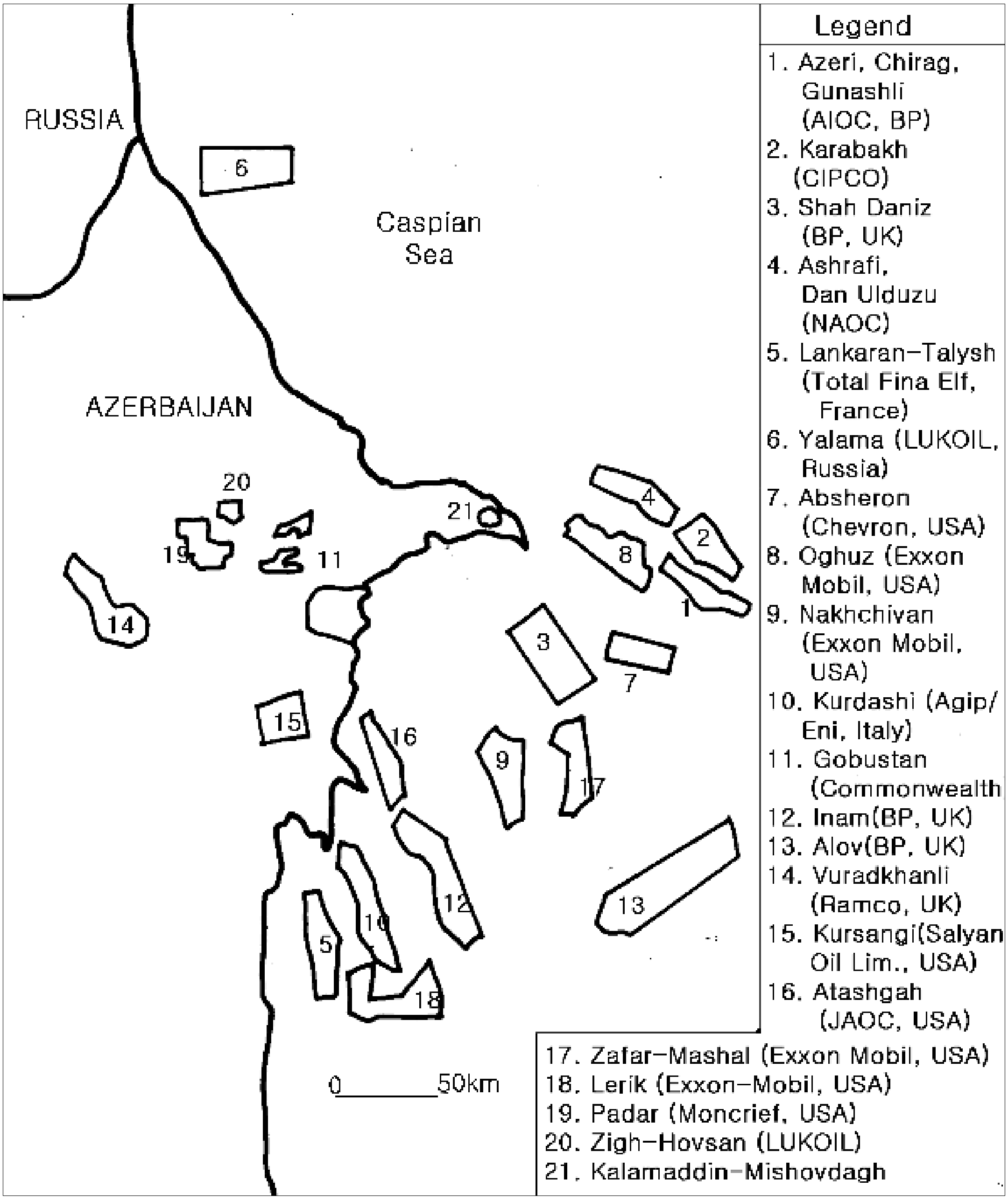
As seen above, the efforts of the Azeri government in attracting huge amounts of foreign capital in the energy sector has been unrelenting. Why has the state on the Caspian Sea been so desperate to attract foreign investment?

The answer to this question may be found in the conflict over Nagorno-Karabakh (NK), a mountainous region within Azerbaijan populated mostly by Armenians.[6)] The dispute began in 1988 when NK declared its independence from Azerbaijan. Then, Azerbaijan enforced an economic blockade of Armenia since the fighting began. Ensuing conflicts lasted almost for six years until 1994, killing more than 30,000 people and driving about 1 million people, mostly Azeris, from their homes to other parts of Azerbaijan (USACC, 2004; U.S. Department of Energy, 2002; Tchilingirian, 1999).

By October 1993, Armenian and Karabakhi forces took control over most of Nagorno-Karabakh (NK). When a Russian-brokered cease-fire took effect in May 1994 affecting the enclave and surrounding areas, an ethnic Armenian government and its militia occupied about one-fifth of Azerbaijani territory. In 1994, the Minsk Group of the Organization for Security and Cooperation in Europe (OSCE), which is co-chaired by Russia, France, and the U.S., was formed to suggest a peace initiative to both sides in the region. Since 1999, several rounds of negotiations between the presidents of both countries involved have tried to find a framework for lasting peace.[7)]

The conflict over NK resulted in numerous and painful casualties to the Azeri state. First, the Azerbaijani government experienced international isolation in October 1992, when the U.S. passed Section 907 of the Freedom Support Act, following the blockade of Armenia by Azerbaijan (BBC RUSSIAN.com, 2004, 9. 29; U.S. Department of Energy (Energy Information Administration), 2002). Section 907 is designed to limit U.S. government assistance to Azerbaijan until October 1998, when partial exemption from the restrictions in Section 907 was allowed. Second, enormous domestic political and social disturbances followed since the beginning of NK fighting. Approximately one million people, out of about 7 million Azeri citizens, were displaced from their homes, thus developing a social strain between the refugees and locals. Furthermore, twenty percent of pre-war territory was wrested from the Azeri government's control (Hoffman, 1999). Third, the fighting for NK took an enormous toll on Azerbaijani economic development. The conflicts caused economic hardships since the region occupied by the Armenian forces was the most productive agricultural area in Azerbaijan where agriculture represents the primary economic sector.

All of these negative consequences of the NK conflict forced the Azeri government to seek the only viable solution, that is, attraction of foreign



Source: Azerbaijan International, 2004,
(http://www.azer.com/aiweb/categories/topics/Oil/oilcontracts_map.html (Nov. 4)

Figure 3. International Oil Contracts with SOCAR

capital for its oil development. By introducing huge amounts of foreign investment in the energy sector, the Aliev government tried to solve a difficult situation in the country.

An unanticipated heavy toll, however, was taken by the government's effort in oil development. Those efforts led to the reinforcement of central authority of the Azeri regime. That is, most oil fields found in Azerbaijan are near the Absheron peninsula, where Baku, the capital of Azerbaijan, is located.

Thus, development of these oil fields had the effect of reinforcing political power of the ruling elite concentrated in Baku, contrary to the example of other countries (Hoffman, 1999).

When resources are located in regions, not in the center of the country, for instance, political bargaining between the ruling elite of the center and other regions is possible, impeding the concentration of all power in the hands of the political inner circle around the President. In oil-rich Kazakhstan, for instance, oil deposits along the Caspian littoral stretch over 1,000 kilometers from the country's political and financial centers like Astana and Almaty. This is not the case in Azerbaijan. As is seen in <Figure 3>, nearly most of 21 oil fields in Azerbaijan concentrated around Baku, the capital of the country or located 60 miles off Absheron Peninsula nearby.

In specific, oil fields situated inland near Baku are the following: (11) Gobustan is operated by Commonwealth, (14) Muradkhanli by Ramco (UK), (15) Kursangi by Salyn Oil Limited (USA), (19) Padar by Moncrief (USA), (20) Zigh-Hovsan by Lukoil (Russia), while (21) Kalamaddin-Mishovdagh was signed in 2000. In the meanwhile, oil fields offshore near Baku and Absheron Peninsula and their operators are the following: (1) Azeri, Chirag, Gunashli, (3) Shah Daniz, (12) Inam and (13) Alov are operated by British Petroleum (UK). (8) Oghuz, (9) Nakhchivan, (17) Zafar-Mashal and (18) Lerik are operated by Exxon Mobil (USA). (6) Yalama is operated by Lukoil, (5) Lankaran-Talysh by Total Fina Elf (France), (7) Absheron by Chevron (USA), (10) Kurdashi by Agip/Eni (Italy), (16) Atashgah by JAOC (Japan), while (4) Ashrafi and Dan Ulduzu and (2) Karabakh are no longer in operation after 1999.

Thus, the geographical concentration of oil fields near the capital of Azerbaijan resulted in the strengthening of an authoritarian Azeri regime, which expedited an alliance between the ruling elite and foreign investment companies. This alliance took the form of a patronage network centered around the President.

3. Oil and Patronage Network

1) Internal Network

This section shows how the patronage network has been consolidated around the President, his family, and his close associates, and how the network between the ruling elite and the oil sector in the country has been mediated through the State Oil Company of Azerbaijan Republic (SOCAR), a surrogate of the regime in Azerbaijan.

According to the World Bank, 78% of the population in "oil-rich" Azerbaijan make a living on less than $2 a day and 56% with less than $1 a day; the average income per capita in 2001 was $618 or $1.7 a day (World Bank, 2001).[8] Similarly, the United Nations Development Program (UNDP) reports that about 80% of Azerbaijanis live on poverty line, meaning that their living standards are among the lowest in all European countries, including Bosnia, Albania and Armenia (UNDP, 2001).

Where have all the earnings from the oil exports gone? The opposition parties argue that most of those earnings have found their way in the coffers of the president, his family members and his inner circle. Since former President Heydar Aliev, father of the current President Ilkham Aliev,[9] took office in 1993, state power has been concentrated in the hands of the President. The President handled most state institutions in an autocratic way. Among presidential powers, for instance, are the appointment of Cabinet members including the Prime Minister and the chairmen of the local executive committees, the declaration of a state of emergency, martial law, and the decision to go to war, to name a few. The Milli Majlis, Azerbaijan's Parliament, can do little to curb the power of the executive since the ruling New Azerbaijan Party (NAP) has swept every national election since 1993. Thus, Azerbaijan is called a 'Presidential Republic (USACC, 2004).

Policy-making belongs to the domain of the president and his close advisers. Extensive patronage networks of the president were formed in various government offices. Most of the President's inner circles are composed of Azeris from the regional tribe of Armenia (Yeraz) and the Azerbaijani enclave of Nakhichevan (Naxcivan), Aliev's native region (Hoffman, 1999, 15; Bayulgen, 2003). In return for their loyalty to the president, they were guaranteed preferential contracts, tax exemptions, or recruitment to coveted government positions.

In addition, Aliev's family members were also given important government positions. While Heydar Aliev was President, his two brothers were among those members of the political council of the New Azerbaijan Party (NAP), the ruling party. Ilkham Aliev, his son and the current President of Azerbaijan, was also the Vice President of SOCAR, the state oil company. This patronage network system of Azerbaijan was even labeled what Juan Linz and Alfred Stepan called a 'sultanistic regime' (Bayulgen, 2003).

It is important to look at how this patronage network allowed corruption to become so rampant in the country. The patronage network generally prevents economic development, destroying respect for law and fair competition. In "oil-rich" Azerbaijan, it is believed that people must be well off with their abundant oil revenues, at least theoretically. On the contrary, the reality is that the rich get richer and the poor poorer. Only the President's family members and the ruling elite have enjoyed the oil wealth. It is because the distribution of oil exploration and production licenses was made, not on the basis of free competition, but of the proximity or bribery to the President and his inner members. Thus, ordinary people are not getting their fair share of the oil wealth due to corruption with the oil sector. Furthermore, the lion's share of oil wealth does not go to the state budget, giving rise to fiscal problems, although the government cites the financial deficit as a pretext for ignoring the hardship of ordinary Azerbaijanis.

At the heart of the corruption network is the State Oil Company of Azerbaijan Republic (SOCAR). According to the Presidential decree in 1992, SOCAR, which employs 70,000 persons, monopolizes nearly all works and functions of the country's oil industry. The President's family members including Ilkham Aliev, the current President and son of the former president of Azerbaijan, and his group members have operated SOCAR. The state company, which is responsible for all aspects of exploration and development related to oil and gas fields, plays a crucial role in designing and implementing oil contracts. Since 1994, SOCAR has signed 23 major oil agreements with foreign energy companies (Azerbaijan International, 2004).

SOCAR maintains a vertical management of state oil companies and related government organizations. SOCAR has been controlled by three actors, who were handpicked by President Aliev: SOCAR President Natig Aliev, SOCAR Vice President Ilham Aliev, son of former President Aliev, and Valekh Alekperov, Director of Foreign Relations Department of SOCAR (Bayulgen, 2003, 214). High-level decisions, including investment, regulatory duties or oil contracts, are made between these three men and the President. The president of SOCAR works as a government-level Minister and reports only to the President directly.

This decision-making vertical system in SOCAR is related with corruption practices, which have been carried out by this vertical management. According to the report of the Committee of Oil Industry Workers' Rights Protection (COIWRP), Azerbaijani officials transfer part (usually about 50%) of embezzled money to their supervisors, and then part of this defrauded money is handed over to the higher officials and so on. At the highest end of these fraudulent chains is the SOCAR president, and above SOCAR is the Presidential Bureau (The Committee of Oil Industry Workers' Rights Protection (COIWRP), 2003).[10)]

The exemplary mechanism of the corrupt networks involving SOCAR is as follows: At first, SOCAR's high-level managers establish their private subcontractor companies in the name of their friends or relatives. SOCAR submits some orders to those subcontractor companies. The invoiced price of the work is calculated much higher than the market price, usually double the ideal cost. The work done is shown only 'on paper' although few or sometimes no work is done in fact. Finally, SOCAR pays the subcontractor companies of SOCAR managers for the work done at the invoiced price. Thus, SOCAR managers take about 50% of the money paid in cash, leaving the rest of the money for the real subcontractors by which the work, if any, is actually carried out (The Committee of Oil Industry Workers' Rights Protection (COIWRP), 2003).

In addition, SOCAR also takes part in an oil smuggling project, and behind the project is the Presidential family, which controls the export and domestic distribution of petroleum production. Ilkham Aliev, the current President and son of the former President, worked as vice-president of SOCAR, and Jalal Aliev, brother of the former President, owns Azpetrol, the national network of gas stations in Azerbaijan. Every year SOCAR, which controls all of the oil shipments outside Azerbaijan, exports about 6.5 million tons more crude oil than the official volume reports by the government through the Georgian ports of Batumi and Poti in the Black Sea, according to Georgian government statistics. The presidential members appropriate the profit from the unreported shipment of oil, about $ 1 billion dollars (Rasizade, 2004a).

2) External Network

Another source behind the chains of corruption is the foreign capital involved in the oil industries in Azerbaijan. Due to the extraordinary relations between Western oil companies and the Azeri government, ordinary people have to bear the burden that results from the corruption between them.

It has been well known from literature on the rentier state that authoritarian regimes excessively relying on natural resources can bring about economic distortion or Dutch Disease.[11)] When a regime depends too much upon a resource that can collect abnormal levels of rents, it tends to be autocratic or authoritarian (Bayulgen, 2003; Hoffman, 1999). Thus, the political power of the regime tends to cluster around the ruling elite. Under the situation, the influx of foreign capital to the regime can help the elite consolidate their political and economic monopolies in the country. It is because incoming foreign capital could play a crucial role in generating significant amounts of oil rent and because the ensuing rent, in the case of Azerbaijan, goes directly to the hands of the President, the Presidential Bureau, and the ruling circles. It is natural that foreign investors generally seek stability for their successful businesses in foreign countries. Thus, they tend to support the authoritarian government that can guarantee a stable environment for foreign businesses. In this sense foreign oil companies play a crucial role in consolidating the authoritarian state and its corrupt practices. Azerbaijan is the typical case.

It has been well known in Azerbaijan that extreme income inequality and poverty result from a close affiliation between Aliev's government and foreign capital. Despite the heavy investment of Western oil companies with $4.1 billion in the country's energy industries between 1995 and 2001, about 65% of Azeris still live below the poverty line. The average monthly wage of Azeris is about $78 (U.S. Department of Energy (Energy Information Administration), 2004). Foreign capital enriched the ruling elite and the Western oil companies on the one hand, but it aggravated the living conditions of the ordinary Azeri people. This is summed up in the following Azeri saying: 'The name of oil belongs to us but the taste of it belongs to others,' (Bayulgen, 2003, 217) meaning that the Azeri people own rich oil fields, but the benefits of those fields flow into the pockets of foreign companies and the ruling elite.

The corruptive patronage network between the Azeri government and Western oil companies is usually consolidated via the bonuses paid by the foreign oil companies. That is, oil exploration and production licenses are distributed not on the basis of free competition, but of close affiliation with the President and his group members. Thus, any foreign company that hopes to participate in the oil industries in Azerbaijan should pay bonuses when any contract is to be signed.

The International Monetary Fund (IMF), for instance, reported that the Azeri government was paid $285 million in signature bonuses by the Azerbaijan International Operating Company (AIOC),[12] when 'the deal of the century' was signed in 1994. AIOC is the first and largest international consortium to tap the Azeri and Chirag offshore fields and the deep-water portions of the Gunashli site (ACG).[13] The report, however, was reputed by the AIOC later when it claimed a payment of $400 million instead (Rasizade, 2003). Out of this bonus payment, about $70 million was credited for the amount paid to the previous AzPF government, led by the former Soviet dissident Abulfaz Elchibey, $60 million was deferred, and $90 million was used to repay Pennzoil for their gas compression project (Hoffman, 1999).

It is difficult to know the exact amount of signature bonuses in Azerbaijan. Given that until now, 20 major field agreements with an overall investment of roughly $55 billion have been made with about 32 companies from 15 countries (Spatharou, 2002, 29; U.S. Department of Energy (Energy Information Administration), 2004), we can imagine how huge the amount of bonus payments could be. These bonuses are generally transferred to the coffers of the President and the ruling elite, thus preventing bonuses showing up on the state budget and deepening the gap between the rich and the ordinary Azeris.

The effect of this malpractice is demonstrated in the in-depth interviews with 20 leading opposition politicians in Azerbaijan in 1999. As shown in the following table, 16 of 20 opposition leaders agreed with the argument that Western oil companies increase the level of corruption in Azerbaijan.

Table 1. Western oil companies' effect on corruption in Azerbaijan

No effect	3
Increases corruption	16
Decreases corruption	0
Both increases and decreases corruption	1
N	20

Source: Heradstveit (2001)

Although Western oil companies themselves are not corrupt, they had to be embroiled in the culture of corruption when the oil contracts were made in the corrupt country. In order to conduct explorations of oil fields and related businesses, the foreign oil firms needed to utilize Azerbaijani infrastructure and services that are riddled with corrupt practices. Those companies cannot do business without being involved in this crooked context. Although no foreign companies reveal that they pay bribes to SOCAR, the Azerbaijani state-owned oil company, they must play a considerable role in institutionalizing the corrupt culture in Azerbaijan. The following statement of an Azeri resident epitomizes how much the Western oil companies are responsible for corruption in Azerbaijan.

> A few years ago someone wrote in an article that the question was whether Azerbaijan would become another Norway or another Nigeria. It looks like the answer is Nigeria -- dictatorship, police state, unemployment and corruption. Ordinary people haven't seen a cent of the contracts with the oil companies, and no one knows where the money has gone. Western oil companies must help stop Azerbaijan turning into a Nigeria -- and they can, if they have the courage to speak out and speak up (Heradstveit, 2001, 282).

3) PSA as a Tool of Symbiosis

The Production Sharing Agreements (PSA) have consolidated the external patronage network between the Azerbaijani government and the Western oil companies, in part. The PSA regime, whose goal is to attract foreign investment, provides a mechanism for contracts describing "the regulatory, financial, organizational, legal and compensatory relationship between investors and host governments"(Bayulgen, 2003, 211).

Contrary to standard tax-and-royalty systems, the PSA regime specifies a share of profits for the host state, allowing foreign investors to recover their investments in the energy sector. Generally speaking, participating foreign companies recoup their capital and operating costs in the form of a share of crude production at the early stage of energy production. The energy output thereafter is divided between the host governments and their investing partners on the basis of the agreement following the PSA. Except for profit taxes, which are assessed at a fixed rate for each PSA, the participating partners are exempt from any other form of taxes by the host governments(Hoffman, 1998, 10; Bayulgen, 2003).

There are many different PSA versions, but the Azerbaijani PSA regime is extraordinary in a couple of aspects. First, the offshore PSAs in Azerbaijan guaranteed considerable bonus payments to the government, in addition to the possibility of a huge cash flow for the Azeri economy. Sometimes bonus payments for contract-signings have reached as high as $300 million, for instance, in the contract between the Azeri government and the AIOC (Hoffman, 1998).

Second, the distinctiveness of the Azeri PSA model is in that it can overrule any other existing law or decree when they are in conflict with each other. Thus, the contract in the Azeri PSA model could promise that the contractor's rights and interests are not subject to any change in the contract without prior consent by the contractor(Bayulgen, 2003).

The PSA regime served as a tool of symbiosis between the Azeri government and the foreign energy companies. The Azeri PSA model could equip foreign energy companies with 'a suit of armor in terms of being able to walk through what would otherwise be dangerous and difficult' (Bayulgen, 2003, 212). For instance, when 'the deal of the century' was made with the AIOC in 1994, the PSA of the Azeri model played an important role in attracting foreign capital to the country. At the time, Azerbaijan was in deep trouble with various factors: hyperinflation, the conflict in Nargorno-Karabakh, and the increase in political pressure from Russia and Iran. Under these pressing circumstances, President Aliev could set the stage for the signing of massive, multi-decade offshore contracts by coming up with the Azeri version of the PSA.

In this process, the SOCAR as the surrogate of the Azeri government tried to come up with the terms of oil contracts so as to be advantageous to the regime. As part of these efforts, the SOCAR's stakes in the PSAs have increased steadily while the other consortia partners burden the up-front expenses in the PSAs.[14)]

In addition, the SOCAR changed the schedule of the expense-recoup and profit sharing in its favor. In order to increase the government revenue, the SOCAR insisted on early "profit oil" in the negotiation of the PSAs for the Kursangi-Garabaghli onshore fields in 1999, contrary to conventional practices. "Profit oil" between the host country and consortium partners in the ordinary PSA regime is usually going to begin only after the foreign consortium partners recoup all upfront costs related with their investments. The SOCAR, however, insisted on an even-shaped production-sharing curve in favor of the host government, allowing the expense recoup period to be spread out (Hoffman, 1998).

For their part, the foreign consortium partners preferred the PSA regime in Azerbaijan, in which there are constant dangers for foreign investments such as weakly institutionalized laws and regulations. The Western energy companies are always subject to unstable legal systems and irregular tax regimes in the country. Thus, the PSA framework could be one of a few reliable means to which foreign oil companies resort. The PSA protected those companies from unpredictable difficulties occurring in daily business within the minefield of developing countries including Azerbaijan. This situation of foreign energy companies was described as "'ring-fenced' through PSA signed with the government" (Bayulgen, 2003, 216).

In this sense, the PSA framework in Azerbaijan serves as an excellent tool of symbiosis between the Azeri government attracting foreign investments and the foreign energy companies securing a safe ground for their businesses.

4. Discussion: Black Gold or the Devil's Curse?

Does oil represent the so-called black gold or a curse in Azerbaijan? To answer this question, it is necessary to look into the reality of the country, especially in the early 1990s when projects for exploration and the development of oil were trumpeted with billions of dollars in potential foreign investment and oil revenues. Those announcements heightened the expectations of the Azeri people for better living conditions. There are, however, several signs that the country has moved backward rather than forward, even after the so-called Azerbaijani oil boom of the early 1990s.

First, out-migration has accelerated even in the midst of the oil boom in Azerbaijan. Following the announcement of the 1994 "Deal of the Century," which promised billions of dollars in foreign investment to the country, for instance, millions of Azerbaijanis left the country, relocating mostly to Russia and other CIS countries.[15)] This is not including the one million refugees, mainly consisting of Azerbaijanis and Armenians, who were driven out in the course of the conflict over Nagorno-Karabakh from 1988 to 1994.

According to sociologist Aleksandr Arseniev, the number of Azerbaijanis, who have moved out of the country, reached 3 million recently. Thus, given that the total number of Azerbaijanis was seven million according to the USSR census in 1989, the number of people in Azerbaijan is no more than 4 million, only about half of the population. Although the Azeri government officially announced that there are 8 million people in the country, based on the 1999 census, the researcher argued that the figure was fabricated (Независимая газета, 1999, Dec. 1).

There is a sign that economic problems have been exacerbated recently. By the end of 1996, approximately 90% of enterprises in the country stood idle without production (Iunusov, 2003, 70). According to the 2003 report by the European Bank for Reconstruction and Development (EBRD), the Gross Domestic Product (GDP) of Azerbaijan has shrunk by 75% since 1991. Similarly, the 2001 EBRD report showed that the GDP of Azerbaijan in 2001 represents only 44% of the 1991 GDP (Rasizade, 2002, 357). More apparent, Engel's coefficient, an index of a food expenditure for a family, has sharply risen from below 30% in 1991 to above 70% recently, signifying the deepening of the poverty level in the country (Rasizade, 2003). Furthermore, in the so-called "oil-rich" Azerbaijan, power shortages have been reported quite frequently.

In addition, the stable social structure is breaking down. The income gap between the poor and the rich, for instance, has drastically widened to more than 10 times the amount it was a decade ago (Rasizade, 2003).

The level of education has also deteriorated after independence. Before independence in 1991, about 90% of Azeri adults received secondary education at least, while over 30% got college education. These days, however, one-third of school-age children in the country, who are occupied helping their parents to earn a daily living, cannot afford to go to school (Rasizade, 2004b).

Given this gloomy reality in Azerbaijan, the influx of billions of oil dollars in the 1990s did not help the country. Some critics argued that huge foreign capital in investment helped the country go backward.

Azerbaijan is not the only country whereby rich natural resources have had a negative effect on the national development. According to a World Bank survey, 18 out of the 28 top oil-producing countries were reported to suffer from corruption, in addition to poor records on democracy and the rule of law.[16] In addition, the latest survey of Transparency International (TI) shows that oil-rich Azerbaijan, Nigeria, and Chad are included in the list of the most corrupt seven nations in the world (BBC News, 2004, 10. 20). More often than not, oil wealth nourishes the terrain for corruption. Sometimes billions of dollars from the oil profits are wasted on corruption and bribery. Invested capital in the oil-related public contracts of those oil-rich corrupt countries, for instance, often ended up in the pockets of government officials, middlemen, state-controlled oil firms, and Western oil executives.

The relationship between natural resources and economic development has been a focal point in rentier state literature since the breakdown of the former Soviet Union. General findings in rentier state literature can be summarized as follows (Esanov et al., 2001; Dalmazzo and Blasio, 2001; Stevens, 2003; Leite and Weidmann, 1999). Abundance in natural resources tends to lessen the incentives to reform especially in energy-rich transition economies. Resource rents, a kind of profit produced by the extraction of natural resources, could be an excellent means by reducing the negative effects of economic reforms in transition economies. Those resources, however, often became a curse rather than a blessing for resource-rich transition economies. Akram Esanov and others even argue that resource rents serve as "the backbone of this reform-hostile political-economic 'oligopoly'" (Esanov et al., 2001, 1). One of the reasons is found in the argument that the authoritarian ruling elite, in transition economies, is prone to appropriate resource rents.

In a similar vein, the Dutch Disease explains economic distortions by enormous resource rents.[17) That is, huge energy wealth results from abnormally large investment in the oil industry, and thus, wages in the energy sector increase, attracting workers from other industries. This causes distortion in wages and prices in other non-energy sectors, crowding out other non-energy industries like agriculture. More specifically, earnings from the energy sector are spent on non-traded goods, leading to a real exchange rate appreciation that decreases the competitiveness of the non-energy industries.[18)]

Symptoms of the rentier state and Dutch Disease are evident in the case of Azerbaijan. In terms of the dependence on natural resources, the exorbitant proportion of foreign investment (74%) is clustered only in the energy sector in the country. Dependence on oil and gas revenues in exports of Azerbaijan in the year 2000 (85.2%) is higher than other comparable transition and oil producing countries, which include Kazakhstan (46.8%), Russia (50.4%), Turkmenistan (81%), Uzbekistan (12.3%), Venezuela (69.8%), Mexico (9.8%), Iran (69.4%), and Norway (0.35%) (Esanov et al., 2001).

Following the breakdown of agricultural and industrial sectors regarding the conflicts over Nagorno-Karabakh, the reinforcement of authoritarian rule has become a theme cited frequently in newspapers and academic journals. The appropriation of revenues from energy-related sectors by the elite surrounding President Aliev inevitably led to chronic corruption, which is currently rampant throughout the whole country.

5. Conclusion

The case of Azerbaijan is significant in that it is typical of many transition economies generated after the breakdown of the former Soviet Union. Many transition economies, especially on the Caspian region trumpeted by the oil boom, are rich in natural resources, but the benefits of those resources are appropriated by the local elite in collusion with foreign companies. Azerbaijan, in particular, is dominated by a series of internal and external patronage networks. Foreign capital nourishes those networks surrounding President Aliev. They, however, turned out to be a major hurdle in the emerging development of the economy.

Thus, the case of Azerbaijan shows that resource rents in the transition economies sometimes do not help in improving the living conditions of ordinary people. What is worse, Dutch Disease, in which disproportionate growth in a certain energy sector tends to crowd out investment in other sectors of the economy by means of exchange rate appreciation, prevails in those countries.

Recently, the Korean National Oil Corp. announced triumphantly the successful commercial production of 5 million metric tons of liquefied natural gas (LNG) in the field of the East Sea, off about 58 kilometers from Ulsan, South Kyungsang Province (Korea Herald, 2004, 11. 8). It is predictable for the Korean people to rejoice at the news in that Korea, the fourth-largest oil importer and the second-biggest buyer of LNG, has been waiting for the news for more than 40 years. This marks the successful result of the nation's time-consuming efforts to produce oil or gas on its own.

The case of Azerbaijan, however, reminds us well that the existence of natural resources alone does not promise the economic prosperity of a nation. Many other factors are required to convert revenues from natural resources into improving the living conditions of ordinary people.

Notes

1) "Azerbaijan, the land of black gold," a 50-minute

TV program, was broadcast on March 17, 2004, on the KBS, a leading television network in Korea.

2) Alec Rasizade (2004a, 191) describes the gloomy picture of Azerbaijan as follows:
"Frequent travelers to Baku are struck almost immediately by the pervasive bitterness and growing sense of deprivation that most citizens feel about their deteriorating lives. The short-lived euphoria of independence has been replaced by the somber realization that the so-called "Transition period" could extend well beyond most people's lifetimes. The promise of peace, freedom and prosperity, which seemed to come with the end of communism, has disappeared into the distance a mere ten years later. After the demise of the USSR, Azerbaijan has been relegated to the category of a Third-World nation. ... The quintessence of profound popular wrath is that the country has moved backward rather than forward since the beginning of reforms. This is the principle outcome of the first decade of Azeri independence."

3) This forecast is based on the statistics of the Energy Information Administration, U.S. Department of Energy (2004).

4) For a listing of these contracts, refer to U.S. Department of Energy (Energy Information Administration), 2004, "Azerbaijan: Production- Sharing Agreements," Country Analysis Briefs: Azerbaijan [http://www.eia.doe.gov/emeu/cabs/azerbjan. html] and "International Oil Contracts with SOCAR," Azerbaijan International, 2004, [http://www.azwe. com/aiweb/categories/topics/Oil/socarcontracts.html] (Nov. 4).

5) The BTC consortium includes the following companies:

BTC Consortium

Company	Country	Stake (%)
BP (Operator)	UK	30.1
SOCAR	Azerbaijan*	25.0
TRAO	Turkey	6.5
Statoil	Norway	8.7
Unocal	USA	8.9
Itochu	Japan	3.4
Amerada Hess	Saudi Arabia	2.4
Eni	Italy	2.5
TotalFinalElf	France	5.0
INPEX	Japan	2.5
ConocoPhilips	USA	2.5

* State Oil Company
Source: Antelava (2003)

6) The population of Azerbaijan is about 7.9 million and ethnic groups in the country consist of Azeris (90%), Dagestanis(3.2%), Russians(2.5%), Armenians (2%) and others(2.3%). Nearly all Armenians reside in the Nagorno-Karabakh region.

7) Regarding the current situation, see BBC RUSSIAN. com, 2004, 'Азербай джан идет в дипнаступление' (March 14) [http://news.bbc.co.uk/hi/russian/press/ newsid_3

8) But official statistics in Azerbaijan indicate that 49 percent of Azerbaijanis live in poverty. Независима я газета, 2004 (07. 30), 'Азербай джан может остатьс я один на один с бедностью,' [http://www.ng.ru/ printed/cis/2004-07-30/4_baku.html].

9) Ilkham Aliev, son of Heydar Aliev, was elected as a new president in October, 2003, but Western observers and the opposition don't recognize the results of the election, which is fraught with voter intimidation, violence and media bias. 'Азербай джан: оппозиция не признает итоги выборов' BBC RUSSIAN.com, Oct. 16, 2003 [http://news.bbc.co.uk/ hi/russian/in_depth/newsid_3195000/3195960.stm].

10) The Committee of Oil Industry Workers' Rights Protection (COIWRP), 2003, "Report on Corruption in Azerbaijan oil industry prepared for EBRD & IFC Investigation Arms" (October, 2003). [www. bicusa.org/bicusa/issues/BTC_Corruption_claim_COI WRP.pdf]. As a matter of fact, the mechanism for corruption is structural in Azerbaijan. For instance, an average wage of government officials was only $30 a month in 1997(average wage of workers across the country $25 a month). Thus they scarcely make ends meet with their official salaries alone. 'Семь партий ных грехов товарища Алиева,' *Профиль*, October 27, 1997 [http://www.compromat.ru/main/ aliev/a.htm]; 'Азербай дан принимает трудные решени я наблюдением МВФ,' EURASIANET, Sep. 18, 2004. [http://www.eurasianet.org/russian/departments/busi ness/articles/eav...].713000/3713099].

11) For more on rentier state literature, see Michael Ross, "Does oil hinder democracy?" World Politics, Vol. 53, No. 3 (2001), pp.325-361; Paul Stevens, "Resource Impact - Curse or Blessing? A Literature Survey," *Center for Energy, Petroleum and Mineral Law and Policy (CEPMLP) Working Paper* (March 2003), University of Dundee, UK [http://www. dundee.ac.uk/cepmlp/journal/html]; Akram Esanov, Martin Raiser and Willem Buiter, "Nature's blessing or nature's curse: the political economy of transition in resource-based economies," *European Bank for Reconstruction and Development (EBRD) Working Paper No. 65* (Nov. 2001) (London, EBRD) [http://www.ebrd.com/pubs/index.htm].

12) AIOC's partners are BP, Unocal, SOCAR, Inpex, Statoil, ExxonMobil, TPAO, Devon Energy, Itochu,

and Delta/Hess.

13) The offshore Azeri Chirag and the deep water Gunashli (ACG) mega-structure is estimated to contain proven crude oil reserves of 5.4 billion barrels. ACG's average daily output is 144,000 bbl/day in June 2004 (U.S. Department of Energy, Energy Information Administration, op. cit.). This production from ACG is named "early oil" and it is exported through the Western route of Azerbaijan, which links between Baku and the Georgian port of Poti/Supsa on the Black Sea. Regarding the route, see <Figure 2>.

14) In the early 1990s, for instance, shares of SOCAR in the AIOC (Azerbaijan International Operating Company, 1994), ACG (Azeri, Chirag, and deepwater Gunashli, 1994) CIOC (Caspian International Operating Company, 1995) and Shah-Deniz (1996) PSAs were 10, 10, 7.5, and 10 percent respectively. But later, despite the drastic drop in world oil prices, SOCAR's share has risen to approximately 50 percent in stakes as seen in the following PSAs: Nakhichevan (1997, 50%), Absheron (1997, 50%), Yalama (1997, 40%), Inam (1998, 50%), Alov (40 %), JAOC (Japan Azerbaijan Oil Company, 50%), Savalan/Dalga/Lerik/Jenab (1999, 50%), and Zafar/ Mashal (2000, 50%). U.S. Department of Energy, Energy Information Administration, Country Analysis Briefs: Azerbaijan (September 2004) [http://www.eia.doe.gov/emeu/cabs/azerproj.html].

15) For further information regarding the Azerbaijani migration after the dissolution of the USSR, refer to A. S. Iunusov, "Migration in Post-Soviet Azerbaijan," *Russian Politics and Law*, Vol. 41, No. 3 (May-June 2003), p. 70 [English Translation of Мировая экономика и международные отношения], pp. 69-83.

16) Only five oil-producing Western countries show good records both on political openness and the rule of law, while five others, all of them being Arab states, do well on the rule of law. Natalia Antelave and Dima bit-Suleiman, "Oil is Not Enough?" *Transition Online* (Sep. 29, 2003) [http://web10.epnet.com/DeliveryPrintSave.asp?tb=1&_ug=sid+B74774].

17) 'Dutch Disease' originated in the case of the Netherlands where natural gas was a leading item in its export in the late 1950s. At the time the country's extraordinary focus on natural gas sector led to the speedy growth of services, transportation and other non-tradable goods while agriculture and other industries lagged behind badly. Oksan Bayulgen, op. cit., ft. 38.

18) For 'Dutch Disease,' refer to Carlos Leite and Jens Weidmann, op. cit.; Paul Stevens (2003), op. cit.; Jonathan Walters, "Caspian Oil and Gas: Mitigating Political Risks for Private Participation," *Center for Energy, Petroleum and Mineral Law and Policy (CEPMLP) Internet Journal*, No. 7, University of Dundee (Sep. 20, 2000) [http://www.dundee.ac.uk/cepmlp/journal/ html/Vol7/article7-5.html]; Hoffman, op. cit., p. 24; Robert Cutler, "The Caspian Energy Conundrum," *Journal of International Affairs*, Vol. 56, No. 2 (Spring, 2003), pp. 89-90.

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