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Pocketing Caspian Black Gold

**Who are the Real
Beneficiaries of Oil
Infrastructure Development
in Georgia and Azerbaijan?**

April 2002

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INTRODUCTION

The Caspian Sea's oil reserves are considered at least as large as those in the North Sea, which currently supply about 8% of the world's oil. Caspian region development through existing oil and gas resources exploitation and its appearance on the world market is a usually prescribed recipe from the International Donor Community and G-7 Governments.

At the end of the eighties, when socio-economic cataclysms took place in the whole territory of the Former Soviet Union, the South Caucasus countries¹ were not unique in terms of economic crisis; however, it was in addition to acute political crisis, due to the hard civil war and ethnic conflicts, a wide range of refugees and internally displaced people, that significantly affected the economic development of these countries. Both countries enjoyed strong social indicators and a remarkably high quality of life in comparison with other republics. As a result of wars and the deterioration of socio-economic conditions, about 60-70 percent of the population of Azerbaijan and Georgia are living below the poverty level, and have experienced disruption of health and education systems, in addition to malnutrition and extremely bad water supply and sanitation, and a severe energy crisis.

The oil and related sector development became a top priority, as the biggest source of large and speedy income for Caspian region development. According to the World Bank, the total investments for Caspian Oil and Gas Exploitation are about USD 140-200 billion, and the private sector is the main source of those available funds. According to the Bank "The need for private investment to realise the full potential of the region's oil and gas reserves is beyond dispute. Attracting such volumes of private investment into a landlocked, conflict-ridden region of fledgling states, inexperienced in market economics, is a massive policy challenge that has only begun to be faced. However, the economies of the region are likely to be trapped in a low-growth scenario, unless they meet this challenge."²

The International Financial Institutions (IFIs) have worked heavily since 1994 to ensure private investments and political risk mitigation in the oil sector, particularly in South Caucasus. It includes reducing the risk through institutional, policy and legal reforms, as well as through "the involvement of public sector agencies, which can give a unique degree of protection to private investors – a so-called "halo effect,"³ that according to IFIs should have "particular value...in the Caspian region, where capital market access is fragile and relations with foreign governments are highly important for geo-strategic reasons."⁴ According to the IFIs, policy in this region is oriented to mitigate the domestic and regional political risks for resource-rich countries like Azerbaijan, as well as to transit countries like Georgia to allocate transparently the oil revenues to high priority expenditures to improve the socio-economic conditions of population.

The US National Energy policy developed by President Bush directly calls for support of the development of new oil explorations around the Caspian region, with a particular emphasis on new oil and gas pipeline construction from the Caspian through Georgia in Turkey. According to Bill Richardson,⁵ "This is not just another pipeline; it is a strategic framework that advances America's national security interests. It is a strategic vision for the future of the Caspian region."⁶

¹ Armenia, Azerbaijan, Georgia

² Mitigating Political Risks for Private Participation , 2000, by Jonathan Walters, World Bank; www.worldbank.org

³ Mitigating Political Risks for Private Participation , 2000, by Jonathan Walters, World Bank; www.worldbank.org

⁴ Mitigating Political Risks for Private Participation , 2000, by Jonathan Walters, World Bank; www.worldbank.org

⁵ former Energy Secretary under Clinton

⁶ Mini-Case and Illustrative Paradigm - U.S. Policy on Caspian Energy Development and Exports; Graham Allison and Emily Van Buskirk; May 2001; Caspian Studies Program - Harvard University, John F. Kennedy School of

The Caucasus and Central Asia were a hotbed of corruption and nepotism during the Soviet era, a trend that has continued even as the region became the energy industry's most promising frontier.⁷ While the presidents of republics are signing new oil deals worth billions of dollars, there is a strict confidence that this wealth will not be shared. "The vast majority of the region's people are still struggling with privation, inadequate services and a ruined environment. So far, their lives have not been improved by the oil boom. The concern is that more development may only make matters worse."⁸

The development of Azerbaijan's economy is largely driven by the activities of foreign oil companies, which are signing Production Sharing Agreements (PSA) with the government of Azerbaijan. According to the IFIs, "PSAs reached with international oil companies have been particularly successful in attracting foreign investment and expertise to Azerbaijan, where contracts have to be passed by Parliament, with the status of laws unto themselves."⁹ However, these PSAs never became public despite their legal status and the public in the country does not know what is written in those contracts.

According to the UNDP Human Development report 2000, "The Government has pursued a highly successful economic reform program in consultation with the IMF, the World Bank, and other international financial institutions since early 1995. The reform program and the revival of the country's oil sector have enabled economic recovery. The increasing dependence on the oil sector, however, has also made the economy vulnerable to external shocks and jeopardised the economic potential of the non-oil sectors." While the government estimates that the economy grow about 11 percent in 2000, the UNDP report clearly states that the lives of 60% of Azeris have not improved. Unemployment and corruption run rampant, and some believe they were better off in the Soviet past. In addition, the economy remains highly dependent on oil. Despite warnings about the bad example of oil-rich countries in the Middle East, there has been little sign that the Azerbaijani economy will diversify beyond petroleum.¹⁰

In Georgia, oil and related sector development is already over-prioritised as a result of the promotion of oil transit. This, combined with policy reforms and private risk mitigation has created a situation in which the Government of Georgia is supporting all oil related, even dubious projects from an economical point of view.¹¹ At the same time, an analysis clearly indicates the smallest share of oil and its related sector development in the State budget.

Government;

⁷ Crude Business corruption and Caspian oil, David McKeebu Research associate, Caspian Sea Oil study Group, CSIS, September 2001

⁸ Commentary: Gloomy picture overshadows oil bonanza By Michael Lelyveld. 08. May, 1999, www.atimes.com

⁹ Transition Report 2001, EBRD

¹⁰ In the first half of 2001, the share of oil extraction and refining in GDP amounted to 36.9 per cent, while non-oil industry accounted for 6.1 per cent. In 1998, these shares were 13.5 and 9.5 per cent, respectively. TACIS, Azerbaijan Economic Trends (Baku), April-June 2001, p. 25 (www.economic-trends.org).

¹¹ This refers to the existing practice of signing presidential decrees that require from relevant ministries to support and facilitate the implementation of particular projects.

1. AZERBAIJAN

1.1 Azerbaijan and its Oil Sector

Oil exploitation in Azerbaijan started in ancient times. Azerbaijan is experiencing its third oil boom since 1892, when companies owned by the Nobels and the Rothschilds competed with Rockefeller's Standard Oil for control of world markets. The existing 3 000 wells produced half the world's oil at that time.

Nowadays, industry experts suggest that Caspian reserves as a whole may approach those of the North Sea. Proven reserves of 780 million tons of petroleum lie beneath the Caspian Sea, and an additional 450 million tons are likely to be there as well.¹² The reserves are thought to be mainly near the Absheron Peninsula, where Baku is located and in the south-western part of the Caspian Sea. In other places, test drilling has yielded natural gas.

All of the top international oil companies in the world have an interest in Azerbaijan. According to Azerbaijan legislation, all petroleum resources existing in its state in underground and surface strata (including a portion of Caspian Sea) are vested in the state of Azerbaijan.

To develop existing oil fields, the Government of Azerbaijan, on behalf of the nation, has granted a number of Production Sharing Agreements (PSAs) to consortia comprised of the oil majors. The first PSA "Contract of the Century"¹³ was granted to the Azerbaijan International Operating Company (AIOC) in 1994 to develop the offshore Azeri-Chirag-Guneshli field. AIOC will develop three major fields expected to total 3 to 5 billion barrels¹⁴ of oil and provide Azerbaijan with roughly USD 80 billion in oil revenue over thirty years.¹⁵ According to the official data, those companies have already invested USD 3 billion in Azerbaijan.¹⁶ The first repatriation of earnings by foreign petroleum companies exceeded FDI in the first half of 2000.¹⁷

Since 1994, the Azerbaijan parliament has ratified a total of 22 PSAs¹⁸ for the exploration of oil & gas fields in Azerbaijan, which could lead to investments of more than USD 50 billion. Each PSA represents a separate law and establishes contractual relations among foreign operation companies and SOCAR (State Oil Company of Azerbaijan, that acts in a dual capacity as a representative of the country's government and as a full member of agreement). Azeri PSAs provide a stable legal and tax framework for international oil companies, and take priority over prevailing and future legislation in cases where PSAs are adversely affected by legislation. The parties to the PSA are subject only to negotiable profit taxes and bonuses, and social charges for local employees. Parties are exempt from all other taxes, including royalties.

¹² Azerbaijan only has a future with Black gold; Alexander's Gas & Oil Connections; volume 6. issue 12-02.07.2001

¹³ See Annex 1.

¹⁴ Azerbaijan Oil: Glimpses of a long History; Perceptions Journal of International Affairs, June-August 1996, Volume I - Number 2

¹⁵ Energy Information Agency (US Department Of energy) report on Azerbaijan , May 2000, www.eia.doe.gov/emeu/cabs/azerbjan.htm

¹⁶ Azerbaijan's Hydrocarbon Wealth, 2000 ; Laurent Ruseckas, Cambridge Energy Research Associates, www.usacc.org/azerbaijan/oil-offshore1.htm

¹⁷ Economic Survey of Europe, 2001 No. 2, Economic Commission for Europe, Geneva

¹⁸ three of which have since dissolved/terminated

Currently, 32 companies from 14 countries are working in the country based on PSAs. All offshore consortiums operate under the PSAs, while the existing number of joint ventures operating onshore will be converted to PSAs.

However, most of the agreement's terms under the PSAs signed by government are secret. The PSAs often specify an up-front bonus payment (as in the first PSA with Azerbaijan) with additional payments after certain production or export levels are reached. Meeting the conditions for the latter depends largely on technical and geophysical factors over which the government has little control.¹⁹

The secretiveness of PSAs also helps to facilitate fear in society,²⁰ foreign oil money flowing in untraceable channels to governmental officials via secret contracts that sustain a corrupt and unaccountable system.²¹

The PSAs precedence over the other laws and the close information regarding the specific terms of PSAs gives a significant burden to the calculation of oil revenues in country.

The State Oil Company of the Azerbaijan Republic (SOCAR) has the authority to control and manage the country's petroleum resources. SOCAR was established by Presidential edict on September 13, 1992 and its initial charter was adopted in November 1992; this presidential authority being consistent with the current *Constitution of the Republic of Azerbaijan*. Its current charter was approved by Presidential edict on April 5, 1994 and registered with the Ministry of Justice on June 24, 1995. SOCAR controls the development of newly discovered fields, and reviews and approves the technological schemes and exploitation projects of oil, gas and gas condensate fields developed by other enterprises. The terms of the charter state that "SOCAR manages the extraction, refining and transportation of oil, gas and gas condensates. The property of the enterprises, organisations and agencies under the control of SOCAR is state property. SOCAR on behalf of the state shall have the right to manage and dispose of this property." SOCAR does not have the power to convey title to these properties to the contractor.

Therefore, SOCAR concluding PSAs with foreign oil companies is acting in a dual capacity; it both represents the Government and also participates as a full member in all agreements concluded with the foreign oil consortia. In negotiations over foreign oil contracts, SOCAR, empowered by presidential instructions, represents the Azerbaijan government. After an accord in negotiations with foreign counterpart(s) is reached, SOCAR reports the same to the President, who upon approval of it entrusts SOCAR with executing the agreement. The agreement is then submitted to the Milli Majlis (Parliament), which adopts the Law on approval of any particular PSA. The provisions of PSAs take priority over prevailing and future legislation in cases where PSAs are adversely affected by legislation.

¹⁹ How to deal with Azerbaijan's oil Boom? Policy strategies in a resource-rich transition economies, " IMF working paper, 98/6. European II Department.

²⁰ According to the newspaper 'Zerkalo' part of the bonuses received by the country to date are in fact loans. The newspaper argues, that foreign oil companies really pay only a certain sum of their bonuses (about 10m) free of charge. However, the government then returns the remainder, or to be more precise, it will be deducted from Azerbaijan's profit from the exploitation of a contract in one way or another and under conditions specified in the agreement itself. According to newspaper information, Azerbaijan will have to return these loans with interest, through relevant deductions from the income tax that the foreign oil companies have to pay. – "Azeri paper raises issue of missing bonuses from foreign oil firms", 05/12/2000; www.eurasianet.org

²¹ Oil Development In the Caspian: Critical investigation of California oil companies in Azerbaijan and Kazakhstan, California Global Corporate Accountability Project, www.nautilus.org/cap

1.2 Budget Revenues from Oil

Since 1995 the Government of Azerbaijan together with IMF and World Bank have implemented structural adjustment and sector oriented programmes. The oil sector has been recognised as promising in that the sources of Azerbaijani medium term development projected that at end of the millennium GDP will doubled based on income from the oil sector.

At same time the World Bank and IMF fully recognised that “Oil revenues could lead to an extreme rent-seeking syndrome, where the windfall gains are quickly spent on uneconomical low rate of return programs and projects, generating implicit subsidies or rent-seeking opportunities. Such a situation could worsen corruption, delay improvements in governance and impede equitable development. However, the same revenues could also be utilised to lay the foundations for sustainable and equitable development and good governance. Since 60 percent of households in Azerbaijan live below the poverty line, prudent and efficient management of oil revenues would provide an excellent avenue to broad-based growth and poverty alleviation.”²² However, despite the implemented programmes for the restructuring of sector, together with financing of private companies for development of concrete projects by World Bank and EBRD²³ in 1995-2000, the institutions fail to ensure the transparency of oil revenues, as well as to address the diversification of country’s economy beyond petroleum. Nevertheless, the support of institutional, legal and private risk mitigation level has not been suspended.

The government budget greatly depends on oil revenues for financial stability. On average, it makes up about 50% of income in the budget. In the first quarter of 1998, when oil prices significantly dropped in the International market, oil revenues accounted for 43% of the total intake, decreasing from 52% in 1997. According to the EBRD,²⁴ oil and gas had a 22,1 and 36,2 percent share in GDP, respectively in 1999 and 2000. Accordingly, 13,8 million tonnes of oil was produced in 1999 and 14,9 million in 2001. From this amount the SOCAR and Domestic producers share is up to 9 million tonnes.

Increasing oil extraction since 1998 has facilitated the predominance of the oil sector and the decline of the manufacturing industry. The sharp increase of oil prices in 1999 had a favourable effect on Azerbaijan’s oil revenues, with the share of petroleum products in total exports composing 86,8% in 2000 (average oil price USD 27,2 per barrel), that increased to 90,3% in 2001 (average oil price USD 24,7 per barrel).²⁵

All of the above clearly indicates the high dependence of the Azerbaijan economy on the fluctuation of world oil prices, clarifying that Azerbaijan could not manage to avoid the adverse effects of the Dutch disease, forecasted already for several years by various institutions.²⁶

During 1991-1999, oil bonuses from the development of new oil fields in Azerbaijan were transferred to the central Bank and held in a special account. According to IMF “only a portion of the oil bonus revenue is used to finance the budget deficit, while the balance remains invested overseas and forms part of international reserves.” According to the IMF this arrangement has been deficient due to the lack of

²² WB CAS evaluation

²³ See Annex 1

²⁴ Transition report 2001, EBRD

²⁵ TACIS, Azerbaijan Economic Trends (Baku), 3 quarter 2001, p. 30 (www.economic-trends.org).

²⁶ How to deal with Azerbaijan’s Oil Boom? Policy Strategies in a Resource-rich Transition Economy, Working paper 98/6; 1998. IMF

formal operating rules, and also that “only the president can authorise the use of these funds, and ownership of the funds is not clearly specified.”²⁷

In December 2000, one of the most popular newspapers in Azerbaijan, “Zerkalo,” raised the issue of oil revenues, especially bonuses received from foreign companies. According to the Newspaper, the Azerbaijani Government should have received USD 695 million within the framework of 17 PSAs. Officially it has admitted to receiving only USD 634 million²⁸, where USD 30 million has disappeared during the governance of Abulfaz Elchibey, in September 1992.²⁹ However, an investigation into the issue has never been initiated.

A comparison of figures from oil contracts, which were ratified by Parliament of Azerbaijan and from the figures of the National Bank of Azerbaijan clearly indicates a misbalance of USD 58 million.

David Woodward, president of the Azerbaijan International Operating Company, said the country had gained over USD 1,3 billion from the venture led by Britain's BP, including a bonus payment of USD 360 million, USD 246 million from oil sales, USD 200 million from local contracting, and USD 108 million in salaries³⁰. However, it was strictly objected to by Azerbaijan president Azerbaijan Aliev, who raised the issue of questions about the wage gap with foreign workers and domestic workers. In the past, Azeri government officials spoke with pride about oil income. Now, they seem more concerned about the publicity.

Azerbaijan oil revenues³¹

	1996	1997	1998	1999	2000
Total Crude Oil production (In millions of tons)	9,1	9,1	11,4	13,8	14,9
(In millions of USD)	1 353	1 276	1 091	1 828	2 342
Export of Crude and oil products (In millions of USD)	402	448	434	801	1 259
(In percent of total export of G&S)	43	39	43	63	69
FDI in oil sector (In millions of USD)	487	845	832	350	788
(In percent of GDP)	15	21	20	9	17
Oil sector imports (In millions of USD)	592	833	642	514	970
Total revenue from oil sector (In millions of USD)	213	331	232	331	
Use of oil revenue (percent of GDP)	8,2	8,7	4,7	5,7	

²⁷ Azerbaijan Republic: Recent Economic Development and Selected Issues; IMF staff country report: 00/121

²⁸ It should be also mentioned that according Turan-Energy news, it is still unclear why the project operator in the Zafar and Mashal contract, the US company Exxon-Mobil, paid USD 97 million as the first tranche of its bonus, whereas the contract to explore and exploit the Zafar and Mashal promising structures (page 122, Article 28-1) shows that the first tranche of the bonus should be USD 75 million.

²⁹ According to the Azerbaijan People's front party leader Abulfeyz Elchibey, half of the oil revenues in Azerbaijan were flowing to the PKK terrorist organisation. 23.07.99, www.turkey.org/news99/

³⁰ Azerbaijan: Wage Gap Becomes Sore Point, <http://www.rferl.org>

³¹ sources : Ministry of Finance and IMF staff estimates; Azerbaijan Republic: Recent Economic Development and Selected Issues; IMF staff country report: 00/121

1.3 State Oil Fund

In order to avoid the dependence of Azerbaijan on oil sector development and to ensure that the oil revenues flow into the state budget, for several years IMF and World Bank have been pushing for the creation of a State Oil Fund, for transparent management of revenues from oil, which constitute about 50% of all Governmental revenues. At the end of 1999, the IMF required establishment of the oil fund as one of the conditions for a new three-year USD 200 million loan for Azerbaijan. On December 29, 1999 President Aliev issued a decree announcing the intention to establish the State Oil Fund.

However, by December 2000 only the charter for the oil fund had been approved through presidential decree, with starting capital around USD 300 million. Funding started in January and by September 2001, the assets already totalled approximately USD 435 million³².

The Oil Fund has four major sources of revenues:

- From sales of the governments share under the PSAs
- From Surplus and performance bonuses, paid by companies under PSAs
- From the rent of sale assets belonging to the government under PSAs
- Income from investing and managing the assets of oil fund

The State Oil Fund is accountable and responsible to the President of Azerbaijan, who has the power to appoint or dismiss the fund's director and approves its supervisory board. Therefore, the main idea of the IMF and World Bank of ensuring that the oil fund would be independent from the Political elite failed on this level.

According to the statute of the Fund, the Oil Fund will collect revenues for the first five years, before expenditures will be made. Spending provisions limit expenditures primarily to interest earned in asset investments, leaving the principal to accrue. According to the Fund Director, the fund assets will be invested in high rated governmental bonds, both domestic and foreign, lent to International Development Institutions.

However, President Aliev has already authorised two draws on the fund. The First USD 36 million was to replace World Food Program for Azerbaijan refugees, then USD 18 million for refugee housing reconstruction.³³

Azerbaijan officials claimed that fund management would be transparent. However, there are still questions from the side of civil society, as well from the International donor community as to how and on what projects the money will ultimately be spent, and how it will be monitored³⁴. The experiences are quite sour.

1.4 Poverty in Azerbaijan

Overall, the discovery of oil rarely means immediate or long-term prosperity for the people who live in an oil producing country. This statement reflects reality for the majority of population living in oil producing lands, among them Azerbaijan. It is considered the poorest country in Europe, with an average per capita income of USD 40 per month for a population of 8 million, with the official poverty line set at USD 89 per month.

³² TACIS, Azerbaijan Economic Trends (Baku), 3 quarter 2001, p. 30 (www.economic-trends.org).

³³ Azertac State information Agency – 03.01.2002

³⁴ Baku and IMF agree on oil fund, By David Stern in Baku, July 12 2001 17:42, www.ft.com

There is a high-level of poverty in Azerbaijan. Considerable discrepancy exists among various sources concerning the scale of poverty in Azerbaijan. Informal sources put the current number living below the poverty line at 80%³⁵, while according to the World Bank, about 61,5% of people are officially recognised to be poor, and 20% of households are considered very poor³⁶. Even during the Soviet period, Azerbaijan was in tenth place among the Soviet Republics in terms of income per capita. Officially, it is declared that Azerbaijan has a high starting point of poverty, when 35% of population fell below the subsistence level of poverty in 1990, directly before the Soviet Union collapsed. After gaining independence in 1991, Azerbaijan experienced a non-declared war with Armenia that resulted in 1 million refugees and IDPs, together with the difficult economic-social and political problems of transition.

The poverty has been aggravated by reduced public expenditures, and an increased number of closed enterprises that have ceased to provide financing for social services and rising pressure on social and municipal services (Due to the non-integration of refugees and IDPs). Nearly one quarter of the country's children are malnourished and two-fifths are suffering from anaemia. Waterborne diseases have become widespread in urban areas due to the low capacity to treat water and ageing pipe networks. Drinking water is available only for 54% of households in country, and for 17% in rural areas and small towns, which have a large share of refugees and IDPs.³⁷ Unemployment is high, even according to the official data it has constituted 18-19% since 1997. Despite considerable foreign investment in Azerbaijan's substantial energy sector, most of the country's population continues to suffer from high unemployment and a low standard of living. The private sector employs less than 25 percent of the labour force.

Recognising the importance of oil and oil related sector development in Azerbaijan for the improvement of socio-economic conditions; it is often looked at as a special advantage of Azerbaijan as having a significant number of native oil engineers and skilled professionals. However, despite the fact average salaries (USD 146) in the oil sector are the highest in Azerbaijan, they are much lower than in any other country in the world. According to an Azerbaijan oil worker, plenty of money is coming into the country "But we see none of it; none today and none tomorrow."³⁸

Oil has transformed Baku from a provincial Soviet capital into an international city with a new airport, hotels and a modern downtown business area in the last five years. However, in a city of 1,7 million, the small Western part is surrounded by poverty, unemployment and collapsing infrastructure. Complaints about terrible economic conditions are usual – a teacher makes USD 20 per month to support a family, while others cannot find work at all. The average wage in civil service is USD 30 per month. Most citizens are engaged in illegal trade activities, which creates the high occurrence of illegal economy.

Others living in the country are in even more terrible conditions. Many are peasants whose farming and livestock are unaffected by advanced technology. Main roads are in disrepair and secondary roads are mud tracks. The main factories are closed. The contrast of the countryside with the Capital often forces people, especially young people, to run away to Baku.

However, protest actions with social claims, demanding jobs, bread, and improvement of living standards from the government in Azerbaijan might be faced with a police cudgel instead of bread, or result in prison instead of a new job.³⁹ For example, war invalids held a hunger strike and the police roughly beat them,

³⁵ Nations in Transition 1999-2000, Freedom House

³⁶ I-PRSP Azerbaijan

³⁷ The Country Classification of Azerbaijan, Asian Development Bank, March 2001

³⁸ "Azerbaijan only has future with black gold", issue 12-02.07.2001; volume 6; Alexander's Gas & Oil Connections

³⁹ Azerbaijan, Weekly analytical-Information bulletin, No: 05 (307), January 31 2002; www.andf-az.org

ignoring their claims to increase their pensions. Dozens of protesters were arrested, and generally all the privileges of the invalids were eliminated.

Power and gas supply outages are common in poor districts of Baku and the countryside. Even Ganja city - the second city of the country - is not supplied with gas and electricity is available only 4-5 hours per day.

Azerbaijan has started to experience the unusual fuel oil shortage that has led to 12 hour electricity shortages in winters since 1999.⁴⁰ In January 2000 the President of Azerbaijan fired two high level executives in the energy sector, however it hasn't improved the situation. According to Natick Aliev, president of SOCAR, it was impossible to purchase fuel oil abroad because of a shortage on world markets⁴¹ to satisfy the country's needs. The public is also experiencing irritation with a decision of the President to stop the import of gas from Turkmenistan due to the budget deficit and has instructed stopping importation. "Naturally, Heidar Aliev does anything at his disposal for himself, his family, and the clan around him to live in special comfort, for organising unseen entertainment shows for his and his son's honour, illegal funding of the election campaign of the ruling party from the state budget. But the money spent for getting gas needed to protect the 7 million local population from the cold seems large in his eyes."⁴²

This approach seems quite interesting in terms of the oil strategy of Azerbaijan described in the I-PRSP document. According to the document the mid-term poverty alleviation is fully focused on development of a new Baku-Tbilisi-Ceyhan Oil pipeline and Baku-Tbilisi-Turkey gas pipeline. At same time the document claims that "the situation with regard to the financial status of SOCAR remains tense due to: first, the impossibility of obtaining payment for fuel oil delivered to Azerenergy, and gas supplied to Azerigaz, which amounts to a subsidy of USD 200 million at regulated prices; second, extremely low crude oil prices for domestic consumers (USD 7 per barrel). In order to transform SOCAR into an economically competitive organisation, the government intends first to increase the supply of gas for electric power generation from year to year, accompanied by a simultaneous increase in petroleum (fuel oil) exports to cover expenditures on gas imports."⁴³

It is of course interesting to have one of the richest gas fields in the world - Shah Deniz - and import gas to meet domestic demands.

After ten years of experiences of this kind of transition, it should not be surprising that most of the people, especially older ones, believe that life was much better under communism.⁴⁴

1.5 Human Rights and Oil

In 1997, the UN Committee on Economic, Social and Cultural rights stressed the "the lack of detailed information on mechanisms relating to the right to form and join trade unions." It notes the absence of a clear definition of "political activities", which trade unions are prohibited from engaging in by the 1994 Law on Trade Unions. It further notes that the categories of workers that are prohibited from exercising their

⁴⁰ "Energy crisis forces Azerbaijan to import crude" - RFE/RL Newline," 26 and 28 January 2000). LF

⁴¹ Energy Crisis Forces Azerbaijan To Consider Oil Imports, Interfax Russian News, January 31, 2000, Monday

⁴² Azerbaijan, Weekly analytical-Information bulletin, No: 05 (307), January 31 2002; www.andf-az.org

⁴³ I-PRSP Azerbaijan

⁴⁴ Hydrocarbons and a New Strategic Region: The Caspian Sea and Central Asia by Lieutenant Colonel Lester W. Grau, US Army, Retire , <http://www-cgsc.army.mil/milrev/English/MayJun01/grau.htm>

right to strike include a broad range of workers in the public service, defence and communications fields.”⁴⁵

Despite the fact that in 1999 a new law Labour Code was adopted, which according to the government is based on International Labour standards, according to the International Confederation of Free Trade Unions “The strongest restrictions on trade union rights are the limitations on the right to strike and the ban on carrying out political activities. The trade unions are also hampered in their work by the failure to transfer trade union dues.”⁴⁶

In the oil Sector the government does not recognise any independent oil workers Trade Union, except for the Azerbaijan Union of Oil and Gas Industry Workers, run by SOCAR. According to the International Confederation of Free Trade Unions in 1998, several Multinationals signed contracts with employees in which they agreed not to join a union, or set one up. It should not be surprising that most of the workers of foreign oil companies are not Union members.⁴⁷ Despite the acknowledgement of the fact that workers at foreign oil companies have much better health, safety and environmental conditions, there is a concern with the enormous difference in salaries between workers of foreign countries and problems of job security.

The violations of human rights, suppression of independent media and freedom of speech, harassment of opposition parties and social protesters, and holding of political prisoners has been permanently highlighted by Human Rights Watch, Amnesty International and the US Department of State.⁴⁸

“Yet the reports have had little impact on life [Of] headquarters of a powerful group with close ties to the government: American oil firms. Executives are reluctant to discuss the political underside of operating in Azerbaijan which, with other Caspian nations, shares an oil strike believed to rival the North Sea in size. Representatives of the leading consortium, which includes Amoco, Pennzoil, Unocal and Exxon, declined repeated requests to be interviewed about the torture allegations. When it comes to human rights, security or other potentially controversial issues, said an Amoco spokesman in Baku: “We’re in the oil business, not politics. So I have no comment.”⁴⁹

1.6 Corruption and Oil

As in the whole Caspian region, corruption is widespread in Azerbaijan. According to Transparency International’s 1999 index, which ranks countries by the number of reported experiences with corrupt officials, Kazakhstan was 84 out of a possible 99.⁵⁰ Its neighbours Armenia and Russia ranked 80 and 82 respectively, while Georgia tied with Kazakhstan, Kyrgyzstan and Uzbekistan, came in at 87, and Azerbaijan, which joins Kazakhstan at the nexus of the Caspian oil rush, ranked a 96. Interestingly, Azerbaijan edged only slightly ahead of energy-rich Indonesia and Nigeria on the index, illustrating that

⁴⁵ Consideration of reports Submitted by State parties Under Articles 16 and 17 of the Covenant Concluding observations of the Committee on Economic, Social and Cultural Rights; UN Committee on Economic, Social and Cultural Rights 5 December 1997

⁴⁶ Azerbaijan Annual Survey of violations of Trade Unions Rights 2001, www.icftu.org

⁴⁷ Oil Development In the Caspian: Critical investigation of California oil companies in Azerbaijan and Kazakhstan, California Global Corporate Accountability Project, www.nautilus.org/cap

⁴⁸ No Rule of Law in Azerbaijan; Abusive Security Forces, Corruption, Must be Brought under Control Azerbaijan: Human Rights Watch World Report 1999. www.hrw.org

⁴⁹ Oil and Human Rights Proving a Complicated Mix in Azerbaijan, by David Case, Freelance Reporter, San Francisco Reprinted with permission of The Chronicle Foreign Service, 1998 <http://www.pewfellowships.org/stories/>

⁵⁰ 99 is the worst point.

economic development and improved standards of living do not necessarily follow from hydrocarbon revenues.

The findings of TI are confirmed by the results of an investigation put together by the World Bank and European Bank for Reconstruction and Development. Among 20 countries in a transitional economy, 59,3% of the companies in Azerbaijan bribe from eight to ten per cent of their annual income⁵¹, and Azerbaijan is a 'leader' on this index. The government of Azerbaijan fiercely rejected the findings of the World Bank, which claimed that the level of official corruption equals USD 1,4 billion, arguing that the real figure is somewhere about USD 100 million.⁵²

Widespread corruption is closely connected with the oil sector, simply because it is largely funded. This includes several problems – failing to account for 2 to 3 million tonnes of oil production per year,⁵³ and the State Oil Company SOCAR, led by close relatives of President Aliiev, the governmental elite responsible for managing oil revenues, taking bribes from foreign companies for better terms of contracts.

While there is a high level of concern regarding the lowering of world oil prices, the budgetary deficit, in circumstances of Azerbaijan high prices could also create unexpected problems. “For example, rising world oil prices made it more profitable to sell oil rather than to refine it. As a result, while Azerbaijan's foreign partners in the Caspian have been exporting up to 115 000 barrels of crude oil per day, the country has run out of fuel oil to fire its power plants. In January 2000 the government of Azerbaijan introduced a schedule for the electricity supply. The official explanation for such measures was the corruption among the energy officials, but this did little to appease the Azerbaijanis, who are certainly used to the problem of corruption and familiar with the empty promises to eliminate it.”⁵⁴

Corruption in Azerbaijan is a main factor providing political sustainability of the power of government sector. It is the main reason for the economic crisis, worsening social situation of the people and deep inequity among society. A corrupted system creates a possibility to negotiate favourable conditions for Transnationals from the G-7 countries.

According to public opinion in Azerbaijan, there is “a consensus that the Western oil industry is at best irrelevant and at worst inimical to the cause of democracy and human rights in Azerbaijan. This is because short-term commercial considerations have led it to kow-tow to the dictatorship, ignore the political opposition and boycott the free media. There is also pay discrimination against Azerbaijani labour. Above all, it was almost universally agreed that the Western oil industry is aggravating the corruption of Azerbaijani life.”⁵⁵

While it is recognised that poor human rights conditions, a high level of corruption and general disrespect for the rule of law and international commitments in government could prevent the flow of foreign direct investment,⁵⁶ the Azerbaijan situation proves the opposite. FDI increased from USD 15 million in 1993 to

⁵¹ “Intervention, corruption and capture: the nexus between enterprises and the state” , by Joel Hellman and Mark Schankerman, , Working paper No. 58 EBRD, 2000

⁵² Azerbaijan Daily Digest, 20 November, 2000

<http://www.eurasianet.org/resource/azerbaijan/hypermil/200011/0043.html>

⁵³ Alec Rasizade , “Azerbaijan, the US and Oil prospects on the Caspian Sea” Journal of Third World Studies. 16;1 1999, p2948

⁵⁴ The Status of infrastructure projects for Caspian Sea Energy Resources, Hearing before the Subcommittee on International Economic Policy, Export and Trade Promotion of the Committee on Foreign Relations, United States Senate, One Hundred Sixth Congress, Second Session, April 2000

⁵⁵ Elite Perceptions of Ethical Problems Facing the Western Oil Industry in Azerbaijan, Daniel Heradstveit, Norwegian Institute for International Affairs

⁵⁶ Central Asia/Russia atimes.com 7 August, 2002 torture, Corruption routine in Azerbaijan

USD 827 million in 1999, and the trend is more encouraging. The corruption system is greatly supported by Transnationals. “It is foreign oil money, flowing in untraceable channels to government officials via secret contracts, that sustains a corrupt and unaccountable system.”⁵⁷

⁵⁷ Oil Development In the Caspian: Critical investigation of California oil companies in Azerbaijan and Kazakhstan, California Global Corporate Accountability Project, www.nautilus.org/cap

2. GEORGIA

As the President noted in a press briefing today, Georgia is not included on the list of poorest countries of the world. "Unfortunately or fortunately, there are a number of states which are poorer than Georgia," he said, commenting on a decision adopted at the G-8 summit in Italy on writing off debts of the poorest countries in a radio interview today, Shevardnadze said the important fact is that such a concept has gained a foothold in global policy

According to the President, many will not like Georgia's inclusion on the list of the poorest countries. However, according to him, after "throwing off this yoke," quick development will start in the country and other prospects will come in sight.⁵⁸

2.1 General Overview

Georgia was once the Soviet Union's wealthiest per-capita republic. However, in the years that immediately followed independence, the Georgian economy fully collapsed. Some of the consequences of the political changes: instability, chaos and a vacuum of power, played a disastrous role in addition to the purely economic effects of the break down of the command economy. Before the break down of the Soviet Union, Georgia had well-developed Agricultural and industrial sectors. Food processing accounted for about two fifths of industrial activity in 1990, followed by light industry (consumer goods, such as textiles and shoes). Electronics and electric engineering was the new, fast growth sector. Agriculture had been the leading activity, highly specialised in citrus fruit, tea, quality wines, tobacco and flowers. In 1990, over one third of the net material product was derived from agriculture, much of it in private hands even before the transition to a market economy.

Directly after the civil war, a new strategy of country economic development appeared that made full use of Georgia's geography and relied heavily on natural resources that, as the government said, would facilitate rapid improvement of the Economy. The new concept of country development represented the shift of country development towards goods, and especially oil and oil product transit. Georgia has been identified as a key country for the Great Silk Road revival project (EU Commission program on Transport Corridor for Europe, Caucasus and Central Asia (TRACECA).

Recently, the completed Baku-Supsa pipeline⁵⁹ was promoted as a "project of the century" that should bring prosperity for Georgia. Only after its completion did it become clear that the annual income of the pipeline would not exceed USD 6-10 million.⁶⁰ Georgia at present receives USD 0,18 for each barrel of oil transported, little in comparison with the usual price of about USD 2 per ton.⁶¹

Georgia's economic situation remains precarious, as evidenced by the fact that Georgia was the only CIS economy to report declining industrial output during 2001.⁶² According to UNDP estimates, about 60% of the population are living under the poverty level and the Gini coefficient for money income⁶³ is about 37, which could be easily compared with Latin American countries.

⁵⁸ Daily News, Economics, July 23, 2001; Sarke Information Agency; www.sarke.org

⁵⁹ Baku-Supsa pipeline was the part of the Early Oil project, developed by AIOC and funded by IFC/EBRD

⁶⁰ In 1999 actual revenue for GIOC from Baku-Supsa pipeline was USD 4,8 million

⁶¹ [USD per metric tone 1,2] EBRD country Investment Profile 1999

⁶² Economic Survey of Europe, 2001 No. 2, Economic Commission for Europe, Geneva

⁶³ PRGF discussion materials, November, 2001

Since 1993, Georgia has experienced a hard energy crisis that is greatly affecting the livelihood of its people, the development of the Georgian economy and is having a negative impact on the environment. The main reason for the energy crisis was the cutting off of the natural gas supply from Russia, shutting down the central heating supply. However, high-level corruption in energy sector and insufficiency of an allocated USD 700 million loans by IFIs and bilateral agencies resulted in zero achievement in terms of energy security for the Georgian population.

Actually, widespread corruption has serious negative impacts on the development prospects of the country. Transparency International's corruption index ranked Georgia amongst the most corrupt of the 99 countries surveyed world-wide (a score of 2,3 in 1999; least corrupt = 10; worst possible score = 0). The World Bank figures show that the frequency of corruption is lower in Georgia than in other transition countries, although the severity of corruption – i.e. the relative importance of bribes – is much greater in Georgia. However, a large amount of the money flowing into Georgia in the last ten years was in the form of credits and loans from MDBs and various bilateral donors. The Georgian foreign debt encompassed⁶⁴ USD 1 989 million at the beginning of 2001. From this amount, roughly USD 1 million comes from IFIs and bilateral donors.

The main implications of corruption are the misspending of public finance, the decreasing of quality of life, an environment that is not conducive to foreign direct investments and, subsequently, poor long-term growth and development prospects. “Georgia nevertheless benefits from a favourable geopolitical position between the oil and gas-rich Caspian sea and Europe; which may have made a foreign critique against corruption milder than would otherwise have been the case.”⁶⁵

In 1995 the World Bank group started collaborating with Georgia in an effort to mitigate the political risks of the Early oil project, the first privately financed oil project in the Caspian region and a major infrastructure investment. The Georgia Energy Sector Adjustment Credit⁶⁶ in 1999 laid the foundation for policy reforms associated with the transit of oil. In particular, laws were adopted providing for eminent domain procedures (compulsory purchase or easements in the public interest) and for environmental liability in case of transportation of hazardous substances (including oil). In addition, Georgia ratified a number of important international treaties related to oil spills.

The World Bank has tried to pave the way for public support of a massive pipeline and other oil transit projects, which will pump oil from developments funded in the Caspian. The World Bank's USD 12,29 million “Georgia Energy Transit Institution Building project,” approved in March 2001, clearly illustrates that this is the case.

However, researchers admitted that “while western oil companies and financiers strut around Tbilisi, this state remains heavily agrarian. Agriculture accounts for a fifth of its production, according to official data, and a 10% jump in agricultural output helped the economy grow 5,2% so far this year. In the cold first quarter, GDP grew only 1,7%. Georgia's mechanics appear unimpressive, though they are mending. Its tax collection rate of 15% of GDP is one of the region's lowest, and the shadow economy accounts for nearly a third of all output and more than half of small business activity. While both these indices improved slightly so far this year, the country's separatist movement and parliamentary squabbles suggest that tax evasion and corruption will persist.”⁶⁷

⁶⁴ EBRD, Investment profile 2001,

⁶⁵ Fighting corruption in Georgia – The need for a long term and comprehensive perspective, Dr. Daniel Linotle and Gianluca Rampole, 25April 2001, Central Asia & Caucasus. Analyst, www.cacianalyst.org

⁶⁶ Georgia – Energy Sector Adjustment Credit of SDR 18.1 million (USD 25 million equivalent at the time – Credit No. 32666-GE)

⁶⁷ Mixed progress, lurking problems: a roundup of regional GDP results, Alec Appelbaum: 8/28/01; www.eurasianet.org

In year 2001, the political turmoil and social crisis was so high that the only positive event according to the Georgian Media was the signing of the Baku-Tbilisi-Ceyhan Oil pipeline and Baku-Tbilisi-Turkey gas pipelines agreements. According to government officials and scientists, the Georgian State budget will get USD 292 million annually, together with additional benefits.⁶⁸ However, the estimates seem to be too optimistic and more promotion rather than reality, in our estimation.⁶⁹

2.2 Oil and Related Sectors in Georgia

Georgia has moderate resources of oil and gas. It is estimated that the total is 540 million tonnes of commercially profitable reserves of oil, of which 300 million tonnes are below land and 240 million tonnes are under the Black Sea.⁷⁰ However, Georgia is to play a key role as a transit state in delivering oil and gas produced in the Caspian Sea region to Western markets.

There are two branches of executive power regulating oil related activities in Georgia and both are primarily responsible to the President of Georgia. The first is the 100 percent state-owned Georgian International Oil Corporation (GIOC), established by the President of Georgia.⁷¹ It aims to construct and rehabilitate oil pipelines and other means of oil transport in the territory of Georgia, oil transportation, oil refining, realising as well as creating corresponding infrastructure and co-ordination and carry out the related finance, banking investment, insurance and other activities. GIOC⁷² is responsible for implementation of the Host Country Agreement⁷³ on behalf of Georgia regarding the Baku-Supsa Oil pipeline and ensuring state dividends transfer in the state budget. It also represents Georgia in implementation of the Baku-Tbilisi-Turkey main oil pipeline, as well as the Baku-Erzurum Gas pipeline in Georgia.

The domestic oil sector of Georgia is regulated under the law on Oil and Gas,⁷⁴ through the Gas and Oil Resources Regulation State Agency. It negotiates contracts, signs agreements and issues licenses and provides a secure legal environment, especially in production-sharing agreements.⁷⁵ According to the Statute it operates publicly and guarantees the transparency of oil operations according to state interests. According to the law, the Georgian State Oil Company - Saknavtobi⁷⁶ - was established to provide support to the Agency and endorse all petroleum agreements, with a primary function of serving as a commercial and operating enterprise. Saknavtobi is developing a joint venture with several oil companies for oil extraction development. The PSAs stipulate that during an initial period, one half of the extracted oil shall be used for recovery of investors' cost and the other half be shared between the investor and Saknavtobi.

The law creates favourable terms for new explorations, including a grandfather clause for existing oil contracts, access for new hydrocarbon discoveries to the existing pipeline, the introduction of rights to

⁶⁸ Report: Energy Potential of Georgia; Macroeconomic analysis of Energy resources and Energy carriers; Prof. S.Tvalchrelidze; January 2002

⁶⁹ In the above-mentioned report only annual income from Baku-Supsa equalled USD 15 million, that is twice the actual revenues.

⁷⁰ IMF staff country report N 211, November 2001

⁷¹ Under the decree N 477, 1995, 11 November and N 178, 1996, 20 February on Georgian Oil International Corporation

⁷² GIOC received USD 10,552 million for Capacity Building under the UNDP Environment Sector, as well USD 1,4 million loan from IDA

⁷³ Host Country Agreements are ratified in Parliament of Georgia

⁷⁴ adopted in 1999.

⁷⁵ The Production Sharing, Risk and management agreements do not require the ratification of Parliament and it is public information (with the exception of confidential information regulated by 25 article of law on Oil and Gas).

⁷⁶ With 100 percent of state shares

expropriate private land for pipelines and exploration, and the right to international arbitration to settle disputes. To encourage further investment, the profit tax for foreign contractors in the oil and gas sectors was cut from 10 to 4 percent in September 1999.

Ramco Energy (UK), National Petroleum (Switzerland) and Frontera Resources committed to fund about three quarters of the USD 150 million for a government program to develop the Kura river basin oilfields. Investments by foreign companies in Georgia's oil and gas sector since 1995 are in excess of USD 150 million. From this amount, the International Financial Institutions have provided about USD 40 million.⁷⁷ It is expected that in 2002, foreign direct investment will increase due to a contract with Anadarko Georgia⁷⁸

Georgian-British Oil Company⁷⁹ (JKX - UK), Ioris veli (National Petroleum LTD⁸⁰) and Frontera Eastern Georgia⁸¹ produced a total of around 540 000 tonnes of oil and 100 million cubic metres of gas from 1995 to 2000.

Extracted oil amount in Georgia (in thousand tonnes)

1997	1998	1999	2000
134,0	119,2	91,3	109,5

2.3 Oil Revenues

Oil and gas developments in Georgia have long been influenced by activity in and around Baku in Azerbaijan. At the end of the nineteenth century, for example, up to 20 per cent of the world's oil production flowed from there to world markets through the Georgian Black Sea port of Batumi.

Nowadays, in addition to the Baku-Supsa pipeline, which transports 110 barrels of "early oil" per day from Azerbaijan, Georgian railway transports significant amounts of oil to Batumi port, located 30 km from the Supsa terminal.

Since March 1997, Chevron has been shipping oil from the Tengizchevroil project in Kazakhstan via barge across the Caspian Sea, where it is then carried by rail across Azerbaijan and Georgia to the Georgian Black Sea port of Batumi. In 2000, approximately 70 000 barrels of oil per day were transiting Georgia via rail, in comparison to 50 000 barrels per day in 1999. The increase of oil transportation is explained by the reduction of tariffs: from USD 8,37 per tonne to USD 5. Based on anti-monopoly legislation, a soft tariff is assessed not only on the freights of "Chevron," but also on the whole crude oil transported by various companies by the railway of Georgia. More than 75% of the revenues of the Georgian railway comes from the transportation of oil and oil-products.⁸²

⁷⁷ 1) In 1998 the IFC committed 6 million USD loan to Ninotsminda Oil Company (Canargo Energy Inc.) for development five new oil fields in Ninotsminda oilfield.

2) In 2000 the EBRD provide 30 million USD loan to Frontera Resources Corporation

⁷⁸ Company is created and exists under Cayman Islands law, it developed contract with the Oil and Gas State Regulation Agency for the extraction of oil on the Western Georgia Sea onshore and offshore.

⁷⁹ Company is created and exists under Cyprus Islands law

⁸⁰ Company is created and exists under Bermuda Islands law

⁸¹ Company is created and exists under Cayman Islands law

⁸² Transportation of Chevron Oil by Railway of Georgia, www.gcci.org.ge/inogate/CHEVRON-1.html

According to the Ministry of Transport of Georgia,⁸³ in 2001 about 12,5 million tonnes of oil and crude oil was exported. 7,5 million tonnes of oil and oil products were shipped through Batumi port, 5,7 million tonnes through Supsa, and through Poti port 0,7-0,8 tonnes of light oil products.

Saknavtobi income results from production sharing agreements with investors. There is no formal agreement between Saknavtobi and the government about what part of company revenues should be sent to the budget. In 1999 and 2000 Saknavtobi contributed 25% of its annual revenue of USD 7,2 million and USD 9 million respectively to the budget.⁸⁴

The revenues from the Baku-Supsa oil pipeline represent the charter capital of GIOC. Georgia receives a very low fee for oil transit through the pipeline - approximately 17 cents per barrel (approximately 1,2 USD per tonne). In 1999-2000 Georgia received USD 11,3 million. In 2001 revenues of USD 6,9 million was expected and from this amount USD 3,2 million was transferred to the State budget as a tax on dividend payments according to a revenue sharing agreement between GIOC and Ministry of Finance.

The annual consumption of crude oil and oil products by the Georgian population is about 5 million tonnes. The entire amount is imported from neighbouring countries. According to a Parliamentary budgetary office conclusion, the largest portion of oil products are imported into Georgia illegally. In 1998 all kinds of taxes on imported oil products went up to USD 44 million, (26,6 percent of all tax incomes). At same time, according to the office's conclusion the actual amount would be USD 300 million.⁸⁵

Export-import of oil and related products⁸⁶ (In million USD)

	1997	1998	1999	2000
Export of Crude oil and related products	14,4	5,7	4,8	12,8
Export of oil and oil related products	13,4	9,2	7,1	6,4
Import oil and oil products (excluding crude oil)	152,2	130,3	57,7	71,9
Import oil, gas and products	75,8	58,5	62,4	48,6

⁸³ Praim-news Agency, 11 December, www.inews.com.ge

⁸⁴ IMF staff country report N 211, November 2001

⁸⁵ report on oil products business and Budget incomes, 1999, Georgian Parliament Budget Office

⁸⁶ IMF staff report N211, data based only on recorded trade

Annex 1. Contract of the Century

On September 20, 1994, the Western Oil Consortium and SOCAR signed a contract for the development of the Azeri, Chirag and Guneshli oilfields.

The complicated negotiations between Azeri authorities and Western companies started in 1990, during the Soviet Period. BP and Amoco lead the negotiations in various terms. The first agreement on the joint development of the Chirag oilfield and exploration in the Shakh-Deniz area was signed with the BP-Statoil alliance. In 1992-1993, six memoranda on mutual understanding of a common works programme for the development of the Azeri, Chirag and Guneshli oilfields were signed. In June 1993, the board of directors ratified the decision on the unification of the oilfields. The declaration includes quite favourable conditions for SOCAR and consequently for Azerbaijan.⁸⁷

However, the planned contract under the declaration terms has never been signed. In June of the same year, President Elchibey was forced to step down due to an action by military forces. The coup caused the death of 40 people, along with violence and repression of Azeri citizens. According to a Turkish secret service intelligence report, the British oil giant BP was allegedly involved in backing a military coup that overthrew the democratically elected government of Azerbaijan in 1993. "As a result of our intelligence efforts, it has been understood that two petrol giants, BP and Amoco, British and American respectively, which together form the AIOC [Azerbaijan International Oil Consortium], are behind the coup d'etat carried out against Elchibey in 1993," said the report.⁸⁸

⁸⁷ The declaration stipulated the following for the development of these oilfields, which were of special importance to Azerbaijan:

- The major goals were to be: rational development of oil and gas resources, efficient and thrifty use of capital investments, minimisation of the exploitation costs, maximisation of the Azerbaijani side's revenues and observance of the sensible economic interests of foreign companies, allowance for Azerbaijan's current and long-term strategic interests and maximisation of local industrial capacities, scientific potential and personnel
- The Azerbaijani side, i.e. SOCAR, had the highest contract share (30 per cent) of all the companies that were parties to the contract. In addition, SOCAR got more than two years additional time to find the financial resources to support its 30 per cent share of expenditure
- Ceding by each foreign company of part or all of its participation share to any other company was to be approved by SOCAR
- a very high bonus rate (USD 3 million) was established for each one per cent of shared participation. A third of that bonus was to be paid no later than ten days after the adoption by the foreign company of the terms of the declaration, and the remaining two-thirds was to be paid thirty days following the contract's coming into force
- A SOCAR representative was to be appointed chairman of the Joint Steering Committee that was then in the process of formation
- Stabilisation of and increase in oil production from the developed part of the Guneshli oilfield was also considered part of immediate tasks
- SOCAR gained the right to take the final decision on the question of operation on the contract territory
- In the shortest possible time, a fund for financing the immediate jobs project was to be created. This fund was also supposed to reimburse the Pennzoil company for its programme for utilising the natural gas from Guneshli and Neft Dashlari oilfields
- If any of the companies were to refuse to accept the terms of the contract, its share could be retained by SOCAR
- All previous agreements between foreign companies and SOCAR on the Azeri, Chirag and Guneshli oilfields that contradicted the terms of this declaration lost their legal force
- A very short term (one week) was established for foreign companies to decide on adopting the terms of the declaration.

All companies participating in the future contract adopted the terms of the declaration within a week and officially notified SOCAR to that effect.

⁸⁸ "BP Accused of Backing 'Arms for Oil' Coup", The Sunday Times, London, March 26, 2000; "Scramble for The Caspian", by Pratap Chatterjee, Multinational Monitor, September 1998; "Azerbaijan's Struggle Toward Democracy",

The new government started negotiation from the beginning and formulated a group of experts of foreign nationalities that was delegated to speak on behalf of Azerbaijan. SOCAR was totally estranged from the negotiation process. This group completed the negotiations in October of 1993. Despite the fact that SOCAR experts found serious deficiencies in the new contract, the new president Haydar Aliyev authorised SOCAR to continue negotiations. The President's son, Ilham Aliyev, was appointed SOCAR's vice-president.

In September 1994, the contract of the century was signed. It was a model of a production sharing agreement and was ratified by Azerbaijani Parliament. Despite the Governmental promotion that under the contract Azerbaijan would get nearly 80 per cent of all the oil profit, the situation in reality was slightly different.

One should note that, compared to the pre-June 1993 version of the contract stipulated by the Utilisation Declaration, certain terms of the new contract were less beneficial to Azerbaijan. This came as a result of the difficult situation in Azerbaijan when the contract was signed in September 1994. This led to the growth of the risk factor and justifiably increased claims by the foreign oil companies.

In the signed contract, SOCAR initially owned a 20 per cent share. However, in the spring of 1995, five per cent was ceded to Exxon (until that point Exxon had not participated in the contract) and another five per cent was ceded to TPAO (TPAO's initial share was 1,75 per cent). SOCAR ceded 10 per cent of its share because it did not have the financial resources to finance its participation share in the programme of minimum compulsory jobs as well as for political reasons.

Exxon and TPAO assumed an obligation to pay a USD 173,2 million bonus and guarantee SOCAR's credits to finance the remaining 10 per cent of its participation share. The Japanese company Itochu joined the consortium in early 1996 with its purchase of a 2,45 per cent share previously held by the American company McDermott and another five per cent from the American company Pennzoil.

The signing of the contract became an important event in Azerbaijan's history and has a strong impact on the nation's future.

The programme for the development of the oilfields involves:

- early oil production and transportation to the Black Sea Coast
- full field development and oil transportation to Mediterranean.

The development of pipelines for transportation is a key element of the oilfield development programme. The northern route for early oil was opened in November 1997 to move Azerbaijani crude to the Black Sea port of Novorossiysk. In April 1999, a western route to the Georgian part of Supsa was completed. The funds were raised by a group of banks, led by the International Finance Corporation and European Bank for Reconstruction and Development. The loan aimed to finance oil terminals, storage facilities and offshore platforms as well as an undersea oil pipeline across the Caspian and the completion of onshore ones from Baku in Azerbaijan to the Black Sea ports of Supsa in Georgia and Novorossiysk in Russia.

The IFC and EBRD provided a USD 400 million credit for early oil project development. "The Caspian hydrocarbon reserves are considered to be at least as large as those in the North Sea which currently supply about 8% of the world's oil," says Linda McCormick, a specialist at the IFC. "But they were barely

by Audrey L. Alstadt, in "Conflict, Cleavage and Change in Central Asian and the Caucasus, (Democratisation and Authoritarianism in Post-Communist Societies, No.4), Cambridge: Cambridge University Press, 1997; "Human Rights Watch World Report: 1994", by Human Rights Watch, www.hrw.org;

touched during the Soviet era, and the surrounding countries remain some of the poorest in the region. In Azerbaijan, the project is expected to start an oil boom whose tax revenues will increase the national budget by 40% over the next 11 years," she continues. "And the related pipeline development should also help Georgia attract more foreign investment than it has received since independence in 1991."

In early 2000, intergovernmental and host government agreements for the Baku-Tbilisi-Ceyhan (BTC) main oil export pipeline were signed and ratified by the parliaments of Azerbaijan, Georgia, and Turkey, and a pipeline sponsors group was formed in October 2000. The USD 3 billion pipeline will transport Caspian crude to the Mediterranean by 2005. The U.S. firm Bechtel was awarded the contract for detailed engineering of the BTC pipeline in May 2001.

According to officials and BP the financing is to come from the EBRD and IFC, which are to lend USD 300 million each. MIGA and OPIC agreed to cover USD 300 million in loans. Overall, a total of USD 1,4 billion of loans are to be made and covered by export credit agencies.⁸⁹ AIOC will submit the necessary engineering documents for the project to international financial organisations, including the World Bank, by July 2002.

⁸⁹ NYT 21 June 01

This paper was prepared by CEE Bankwatch Network

CEE Bankwatch Network is an association of non-governmental and non-profit civic organisations from Central and Eastern European countries.

The CEE Bankwatch Network's mission is to prevent environmentally and socially harmful impacts of international development finance, and to promote alternative solutions and public participation.

The goals of the CEE Bankwatch Network are:

- To create public awareness about International Financial Institutions activities in Central and Eastern European countries and their social and environmental impacts.
- To promote public participation in the decision making process about policies and projects of International Financial Institutions, on the local, national and regional levels.
- To help non-governmental environmental organisations and citizen groups to monitor what the International Financial Institutions are doing in the Central and Eastern Europe.
- To change or stop environmentally and socially destructive policies and projects of International Financial Institutions in Central and Eastern Europe, and promote alternatives.
- To cooperate with environmental citizen organisations in stopping destructive activities of Transnational Corporations and to limit their overall impacts on the environment in Central and Eastern Europe.



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