

## **BIG POLITICS IN SMALL SPACES: WHAT ARE AZERBAIJAN'S PROSPECTS IN THE GEOPOLITICAL ARENA?**

**Vladislav Inozemtsev**

D. Sc. (Economics) Director, Russia's Center for Research into the Postindustrial Society

The 1990s are well known to have been a difficult period for the peoples of the newly independent states that emerged on the territory of the former Soviet Union, but it can be asserted confidently that it was the Transcaucasian countries that suffered most. Even in the Soviet Union's last years, conflicts were already breaking out in the region, first between Azerbaijan and Armenia, then in Georgia, and somewhat later in Chechnya (the last also affecting all neighbouring countries in one way or another).

Right up to the end of the century, the Caucasus was viewed both by Russia and the other great powers as a zone of heightened conflict. "Big-time politics" in the region presupposed, above all, the development and implementation of various measures to "freeze" military conflicts (given that a large part of Azerbaijan's territory is occupied by Armenia and Russia is providing support to separatist regimes in Georgia, the idea of actually resolving these conflicts is still out of the question). The same period also saw the economic crisis reach its zenith: Georgia's GDP dropped to 44.2% of its 1989 level, that of Armenia by 71%, and that of Azerbaijan by 54.7%. This region, traditionally seen as a strategic one, was just a headache for politicians.

The situation began to change back in the mid-1990s, when the experienced and responsible politicians Heydar Aliyev and Eduard Shevardnadze came to power in Azerbaijan and Georgia. Both these leaders were well aware that the post-Soviet economic crisis could be overcome only by integrating their countries into the global economy, above all by reinstating Azerbaijan as a major oil extracting power and Georgia as a transit country. In 2002, construction work was launched on the Baku-Tbilisi-Ceyhan oil pipeline, which was commissioned in 2006. Essentially, from this time on, a truly serious political game began in the Transcaucasus, the ace-in-the-hole today being deliveries of oil and gas from the Caspian region – one of the world's richest in hydrocarbons, squeezed between the increasingly unstable Middle East and Russia, which is becoming more and more "unpredictable" in the eyes of some western politicians.

### **Azerbaijan's Energy Potential: Yesterday and Today**

Azerbaijan was associated with oil long before it became an independent state. It was in the Baku area that extraction began of what was still Russian oil back in the late 1870s; it was here that Ludwig Nobel laid the first oil pipeline and built the first tanker to take Baku oil to the mouth of the Volga, whence it was transported by barge to the central regions of Russia. The rapid development of new oil sources, using what were, at the time, the state-of-the-art technologies of foreign investors (primarily Nobel and Rothschild), allowed Russia to become, in 1898, the world's biggest oil producer and kept the USA out of the top slot for four years. In 1901, Russia extracted 11.98 mln.t. of oil per annum, about 90% of this coming from the Baku region. Considering that, at that time, Russia and the USA supplied about 95% of the entire world's oil<sup>1</sup>, a hundred years ago Azerbaijan could be said to have been the main "energy superpower" in the world. Today, of course, the situation has changed fundamentally, but many factors allow indicative parallels to be drawn with the beginning of the 20th century.

On the eve of the collapse of the Soviet Union, the Soviet oil industry was focusing mainly on Western Siberia, where over 63% of all the oil and almost 70% of all the gas was extracted in the country. The possibilities of the Caspian region were considered to have been mostly exhausted. The subsequent economic crisis meant that, in 1994, independent Azerbaijan was extracting only 9.6 mln.t. of oil a year, with Russia as virtually the only monopoly buyer of the crude. Former glories were apparently things only of the past (extraction in Azerbaijan peaked in the difficult war year of 1941 at 23.4 mln.t). In contrast to their Russian colleagues, however, the leaders of Azerbaijan (and Kazakhstan) boldly turned to western oil companies with the intention of reinstating their century-old successes. In the autumn of 1994, a contract was concluded for development of the Gunashli, Chirag and Azeri deposits. The parties to the agreement were 10 oil companies: Azerbaijan's GNKAR having a share of 10%, and British BP and US Chevron, Exxon Mobil, Devon Energy and Amerada Hess holding an aggregate of 60.7%. Virtually the same distribution was established for development of the huge Shah-Deniz gas deposit, the contract for which was signed in the summer of 1996 (this time BP, the Norwegian Statoil and French Total controlled 61% of the operator's shares)<sup>2</sup>. Today it can be stated without exaggeration that the results have

<sup>1</sup> Calculated from: Marshall Goldman. *Petrostate. Putin, Power, and the New Russia*, Oxford, New York: Oxford Univ. Press, 2008, table 2.1, p. 36.

<sup>2</sup> For income data, see: Michael Klare. *Rising Powers, Shrinking Planet: The New Geopolitics of Energy*, New York: Henry Holt & Co., 2008, table 5.2, p. 138.

exceeded all expectations: in 1993, about 8.5 mln.t of oil were extracted in Azerbaijan, the respective figures for 2000 and 2007 being about 14 mln.t. and 42.8 mln.t<sup>3</sup> (for comparison, oil extraction today in Russia is still almost 10% less than in 1990, the first six months of the current year having seen, moreover, a drop in the extraction volumes of virtually all oil companies). Against this background, the almost five-fold increase achieved by Azerbaijan since 1990 remains the record in the former Soviet republics.

The successes achieved by Azerbaijan and Kazakhstan, the other Caspian oil and gas giant, (which is also actively involving foreign companies in developing its deposits) resulted, in the second half of the 1990s, in western countries overoptimistically assessing the reserves and extraction opportunities in the Caspian region. There was talk of immeasurable reserves, reaching 200 bln. barrels of oil equivalent, this being comparable with the reserves of the biggest Persian Gulf oil exporters. As the deposits were more actively developed, the estimates dropped to 17-45 bln. barrels, the upper limit thus coinciding with the estimate of reserves on the territory of the USA, including the oil of the Gulf of Mexico. Yet even such possibilities (especially since it is now believed that, by 2020, the Caspian countries [with the exception of Iran] will be able to more than double their current extraction levels) inevitably initiated the big geopolitical game now being played by Russia, the USA and Europe, as well as China (to an increasing extent, moreover).

Essentially, a mighty energy resource production centre is now taking shape in the Caspian Basin and the Central Asian hinterland. Even though it may not yet be comparable with the scope of the Middle East and Russian ones (see Table 1), it is of critical importance for the global oil and gas markets. Azerbaijan is one of the leaders in this block, although not in terms of extraction volumes, but at least in terms of growth rates (in 2007, for instance, the Republic's oil extraction rose by 31.7%, and that of gas by 63.2%). The countries of Central Asia and Azerbaijan are experiencing no shortages of investments or resource base (and are unlikely to do so in the near future), but they have been facing a common problem: to find reliable and safe ways to export their energy resources (Let us note that, in all these countries [with the exception of Uzbekistan], the proportion of the oil and gas used in their national economies is closer to the Middle East figure of 15-20% than the Russian figures [in 2007, Russia consumed about a third of the oil extracted in the country and about two-thirds of the gas]).

**Table 1**  
Comparison of the main hydrocarbon extraction regions of Eurasia  
(as of end 2007)

	<b>Arabian Peninsula</b>	<b>Russia</b>	<b>Central Asia and Azerbaijan</b>
Oil (reserves)	68 100	10 900	6 500
Oil (extraction)	863,5	491,3	126,2
Gas (reserves)	41 900	44 650	7 600
Gas (extraction)	233,1	607,4	163,5

<sup>3</sup> See: *BP Statistical Review of World Energy*, June 2008, p. 9.

\* Oil data given in mln.t., gas -- bln. cub.m

\*\* Source: *BP Statistical Review of World Energy*, June 2008, pp. 6, 9, 22 and 24.

This underlines the significance of export corridors, yet all the Caspian oil-producing countries are landlocked and none of them have land frontiers with the main consumers of their output. The current wave of geopolitical rivalry in the region thus centres round access to world markets.

### **Politics and Economics**

Let us note at once: the interests of the main rival parties are not so much diametrically opposed as different in essence. The oil and gas extracting countries of the region – Azerbaijan, Kazakhstan, Turkmenistan and, to a lesser extent, Uzbekistan – are striving to find effective and reliable transit and sales routes for their output. Russia, on the other hand, to speak plainly and not beat about the bush, intends to consolidate its position if not as a “monopoly buyer” of the oil and gas coming from the region, then as the only transit country for them to reach western consumers. The consumers themselves, however – the USA and the countries of the European Union – advocate increasing supplies of energy resources to the global market and a bigger overall supply in the world (in the hope that this might rein in oil prices at least to some extent). In the given context, Russia’s position appears objectively to be one of “imposing services” and will be perceived as such even if the Kremlin is motivated by the best intentions towards the countries of the region. After all, Russia is, in essence, suggesting that Azerbaijan and the Central Asian states give up the hunt for alternative product export routes, though it is actively involved in this itself, by laying the Nord- and South Stream gas pipelines and the Eastern Siberia-Pacific Ocean (ESPO) and Burgas-Alexandropolis oil pipelines. At the same time, in recent years Russia has gained the reputation of an extremely difficult partner: up until 2005, it took advantage of its monopolistic position to buy up gas from Turkmenistan and Uzbekistan at discounted rates; it has repeatedly refused to increase the capacity of the Caspian Pipeline Consortium; it has brought pressure to bear on Azerbaijan and Georgia in an attempt to impede construction of oil and gas pipelines allowing Azerbaijan’s energy resources to reach world markets without using Russia’s transit pipelines. For this reason, the efforts made by Azerbaijan and the Central Asian republics to rid themselves of such “equal and mutually beneficial” co-operation are quite understandable.

In this situation, Azerbaijan’s position becomes of critical significance for at least two reasons. First, since the laying of the Baku-Tbilisi-Ceyhan pipeline, Azerbaijan has maintained close and constructive relations with Georgia, which is the “natural” transit country in the Transcaucasus region. These relations remained intact after the change of power in Tbilisi and Baku in 2003 and are today still on the rise. By supplying Georgia with vitally important energy resources, Azerbaijan has consolidated its status as the chief “energy player” in the Transcaucasus. Second, and perhaps even more importantly, for the Central Asian states, Azerbaijan is their route not only to the West, but also to the ports on the Black Sea and the Mediterranean, allowing them to sell oil and other goods not only to a specific buyer country, but on the world market, to anyone offering a good price. This is particularly important in that all alternative energy resource transportation routes – oil pipelines from Kazakhstan to China, gas pipelines from Turkmenistan and Uzbekistan again to China, as well as the planned Trans-Afghan gas pipeline – give the suppliers greater freedom but not radically so: dependence on Russia is replaced by subordination to China and, considering Beijing’s ambitions in Central Asia and its economic potential, this appears maybe even more dangerous than a unilateral orientation on Russia. Only if they have oil and gas transport routes that are of the required capacity and run to the Mediterranean ports can Azerbaijan and the countries of Central Asia consider their export problem solved. Construction at Turkish ports of gas liquification terminals for supplying the global gas spot market would appear to be the culmination of this process. Azerbaijan’s politicians should not be playing “against Russia” or “for the United States”. They should stand up for their own interests and those of their partners in Central Asia, since neither Russia, Europe, the USA nor China is interested in resolving the region’s internal problems: each player here pursues its own ends, which do not always coincide with those of Azerbaijan and its partners.

There can be no doubt that, in the next few years, the region will see an increasingly fierce battle for access to the energy resources of the Caspian states. The most active players will definitely be Russia and China, as they view the task of consolidation in the region not only from the economic, but also the political angle. The United States and the European Union, in spite of the frequent accusations of being politically motivated, focus their attention more on the economic side of the coin, and this is precisely what explains the very limited progress in construction of the Nabucco pipeline. The financing of major new transport projects is today becoming the business of the exporters themselves: for instance, Azerbaijan is currently assuming almost the entire financial burden (by extending a \$200 mln. [US], 25-year loan to Georgia at a symbolic 1% per annum) of the project to lay the Baku-Ahalkalaki-Tbilisi-Ceyhan railway line and is also building, in Baku and its hinterland, terminals for storing Kazakh grain and other goods that could be exported by the new trade route. Big international companies or banks might provide substantial help but, one way or another, the task of ensuring stable exports of energy

resources and other goods from the region should and will be fulfilled by the efforts of the Caspian states themselves.

Russia now finds itself in a quite difficult situation, which the governments of the Caspian Basin are bound to take into consideration. The main idea pursued by Russian politicians in recent years has been to prevent any alternative routes being established for transporting oil and gas from Central Asia to Europe. The main reason for this policy we see not as any “imperialist aspirations” on the part of the Kremlin, but as the growing difficulties Russia is encountering in maintaining its energy (above all) gas balance.

The huge Russian corporation Gazprom has recently been engaged in all sorts of business other than gas extraction. Its main deposits on the Yamala Peninsula – the Bovenenkovskoye and Kharasaveiskoye – are hardly being developed at all (last year, only \$1 bln. were allocated out of the \$17 bln. required to bring them on line), while the funds spent over the last five years on purchasing only non-core business assets (\$16.4 bln.) almost match investments in development and construction of gas deposits (\$18.5 bln.). As a result, at the end of 2007, the value of the core business assets used in production and transportation of gas had dropped to 50.3% of Gazprom’s total asset value<sup>4</sup>, while the company’s corporate debt had reached \$52.8 bln., or 80.3% of the revenues from sales of gas on both the domestic and the foreign market<sup>5</sup>. In 2007, there was a 0.8% drop in gas extraction in Russia and an almost 11% fall in Gazprom profits.

Yet the Russian government is trying more and more actively to draw Gazprom and the oil companies into its political games, the main one being construction of new pipelines. By 2013, when the Kremlin intends all current projects to be commissioned, 80 mln.t of oil a year will be exported along the ESPO and 35 mln.t along the Burgas-Alexandropolis branch, while the capacity of the Nord- and South Stream will be 55 and 31 bln. cub.m. of gas a year, respectively. Given the falling rate of extraction of oil and gas, fully loading these new arteries appears virtually impossible, which is the main explanation for Moscow’s interest in the energy potential of the Caspian countries. In Baku and Ashgabat negotiations held recently by the Gazprom management, during President Medvedev’s visit to Azerbaijan and Turkmenistan, the head of the company, A. Miller, suggested that the partners “buy up all the gas produced in these countries at market prices”. A week after the negotiations, which were hardly a total success for Gazprom, he repeated the same idea in Algeria, this time with respect to Algerian gas. Considering that drilling work has not even been launched yet at Gazprom’s major project – the huge Shtokmanovskoye deposit, one can be sure that Russia’s dependence on Central Asian gas can only grow over the coming years. Azerbaijan, as the chief operator of alternative gas and oil transit routes from Central Asia, is becoming a leading player on the energy market of the Caspian region.

The most important choice in this situation will be that of transport routes for energy resources and of the main purchasing partner. For Azerbaijan, the most reasonable strategy in the current situation would, in our opinion, be to orientate sales of its own output towards the markets of the western countries and to pursue a policy geared to the Central Asian suppliers distributing their export flows in relatively balanced proportions between China, Russia and the West (supplied with the oil and gas via the Trans-Caspian pipeline). The capacity of the pipeline system leading from Azerbaijan to Georgia and Turkey should continue to be increased, allowing Turkmenistan and Kazakhstan room for manoeuvre in negotiations with Russia. As we see it, there will be no unique orientation of the Central Asian countries towards any single market in the near future and Russia might become a serious competitor for Azerbaijan if it goes for an increase in the capacity of the Caspian Pipeline Consortium and agrees to deliver Central Asian gas to Europe along the Blue Flow pipeline or the South Stream system. The problem here, however, is that the cost estimates for laying new pipelines in Russia are 1.4 to 5 times more than the unit cost of the Turkish sector of Blue Flow or the Baku-Tbilisi- Ceyhan pipeline. Consequently, Russia will, most likely, try to transfer the construction costs on to future exporters and what might seem, at first glance, an attractive transit route, might prove less beneficial than supplies via the Transcaucasian pipeline, if it is in operation by that time. Moreover, considering that Russia will step up its pressure on the EU countries in an attempt to remain the monopoly supplier of gas to their markets, it is extremely likely that the Nabucco project will never get off the ground. In order, therefore, to maintain their appeal, the Trans-Caucasus gas transit routes will require gas liquification facilities at Black Sea or Mediterranean ports.

When establishing relations with their partners (and for Azerbaijan, in contrast to Kazakhstan or Turkmenistan, which can orientate themselves to China, the only possibilities are Russia and the West), the leaders in Azerbaijan need to take account of the specifics of Russia’s foreign policy strategy, which is distinguished by serious radicalism, especially in the former Soviet republics. With the exception, perhaps, of Kazakhstan, Russia has as yet been unable to establish with any newly independent state of the former Soviet Union relations that the well-known Russian expert S. Markedonov calls “limited co-operation”<sup>6</sup>. The situations arising from the relations with Uzbekistan in 2002-2005, Georgia since 2004, Ukraine since 2005, as well as Moldova after 2004 and the Baltic states, show that Russia is prepared either to count these countries as its allies or to pursue a quite confrontational policy towards them. Besides, Azerbaijan has limited room for manoeuvre in the oil and gas

<sup>4</sup> See: *OAO Gazprom IFRS Consolidated Financial Statements*, 31 December 2007 (released June 30, 2008), p. 20.

<sup>5</sup> See: *Ibid.*, pp. 35-36.

<sup>6</sup> See, for example: Sergei Markedonov. Limited Co-operation. Commentary to the Russian President’s tour of the East. <http://www.polit.ru/analytiks/2008/07/10/lez.html> (retrieved on 12 July 2008).

sphere: it would not be beneficial for it to agree to sell all its gas to Russia; but it would be fatal to reject the plans to expand Trans-Caucasian transit for the sake of strengthening relations with Moscow. A period of cooling relations between Azerbaijan and Russia might, therefore, be anticipated over the next few years; since Russia's policy is unlikely to change (today it is becoming increasingly clear that President Medvedev is still, in his policy with respect to the CIS countries, acting primarily as head of the Gazprom Board of Directors).

### **Internal and Regional Problems**

The political situation in the Transcaucasus, where Azerbaijan is the leading power, is not, of course, determined by energy problems alone. Two other important aspects impacting upon it are the objective economic weakness of the neighbouring countries (as well as the far from ideal situation in Azerbaijan itself) and the unresolved regional conflicts restricting the Transcaucasian states' politicians in their manoeuvring.

The chief geopolitical problem for the Republic of Azerbaijan itself consists in the unresolved Karabakh conflict with Armenia, which is Russia's chief ally in the Transcaucasus. For Georgia, a similarly acute problem is that of separatism in Abkhazia and South Ossetia, whose governments enjoy the protection of Moscow. The situation is exacerbated by the fact that the western powers to which Azerbaijan and Georgia might appeal do not, objectively, exert a very great influence in the region and have no intention of entering into a conflict with Russia over the situation beyond the Caucasus. Even membership of NATO, towards which Georgia is striving and that the Azerbaijan leadership is considering as a possible future prospect, is unlikely to be able to change the situation. Neither the Karabakh conflict nor the clashes over Abkhazia and South Ossetia have, in my opinion, any chance of being resolved in the foreseeable future. All the participants in the Transcaucasian conflicts recognise that any disruption of the status quo might entail dramatic changes, so are not prepared to take any decisive action. Even though both Azerbaijan and Georgia have been making considerable efforts in recent years to modernise and develop their armed forces (in 2007, Azerbaijan's military budget was 4 times the 2002 figure and that of Georgia – 10 times greater), their armed forces still objectively remain weaker than those of Armenia and Abkhazia, respectively. Besides, Armenia de jure and Abkhazia de facto are tied to Russia by collective security agreements, so it is difficult to imagine that the authorities of Azerbaijan and Georgia are prepared to launch military actions against the separatist enclaves. In the given situation, the task facing all forces with a vested interest in a civilized solution to the conflicts is to develop a longterm plan for settling them on the basis, on the one hand, of recognition of the sovereignty of Azerbaijan and Georgia over their breakaway territories and, on the other hand, in consideration of the will (and rights) of the peoples living there.

As we see it, such a plan would, first of all, have to provide for "restricted sovereignty" of the separatist territories and secure this status for a period of 20-30 years, until the situation in the region becomes clearer and more predictable. All the great powers with interests in the Transcaucasus – Russia, the European Union and the USA – would declare non-interference in the conflict, while Azerbaijan and Georgia would need to guarantee inadmissibility of military actions on their part. UN or European Union missions could be located on the relevant territories; while the populace would be issued passports in a new format underlining the special status of their holders (rather than being citizens of Armenia [in the case of Karabakh] or Russia [in those of Abkhazia and South Ossetia]). The UN or EU missions in these autonomous areas would provide consular services for their residents, while Russia, the EU and other countries of the region would undertake to recognise these documents. The task that must really be fulfilled today is, in my opinion, not that of returning the breakaway regions to the embrace of Azerbaijan and Georgia respectively (which, judging realistically, is simply impossible), but of securing the current status for an indeterminately long period in order to preclude their actual incorporation into Armenia and Russia, which would make the situation irreversible. It seems to me that, to this end, Azerbaijan and Georgia should make certain concessions – but only provided that, going forward, the role of the main mediator transfers from Russia to the United Nations or the European Union. Subsequently, in 20-30 years' time, the geopolitical realities in the region may be substantially different from those of today, at which time the territorial reintegration of Azerbaijan and Georgia might be achieved more benignly than might be supposed proceeding from the present experience of the 1990s and 2000s.

The next serious geopolitical challenge for the Transcaucasus is posed by the actions of the United States of America and its allies in the region of the Greater Middle East, as the countries of the Persian Gulf, Iran and Iraq are called nowadays. Of particularly high priority for Azerbaijan are relations with Iran and the situation surrounding this country, which is extremely tense at the moment. Few people would doubt any more that Iran's nuclear programme is not geared to peaceful use of nuclear power (the country has some of the world's biggest oil and gas reserves and is hardly in need of it) but to obtaining a nuclear weapon in the relatively short term. The USA and, to an even greater extent, their main ally in the Middle East, Israel, has repeatedly declared, in one way or another, that continuation of Iran's nuclear programme is inadmissible – and there are serious grounds for believing that they will do all within their power to prevent this programme reaching its culmination. In this situation, a military attack on Iran's nuclear facilities at the end of this year, between the presidential elections in the USA and the new president assuming his post – most likely, moreover, by Israel rather than the United States –

seems quite probable. This might have extremely adverse effects for Azerbaijan, considering that a large number of ethnic Azeris live in Iran and the economies of Azerbaijan and Iran have been becoming increasingly intertwined in recent times. In our opinion, the USA's policy towards Iraq, Iran and partly Pakistan constitutes an even greater threat to the Transcaucasian region than the latter's internal conflicts, which, let me repeat; currently appear to be frozen, rather than fraught with any open military confrontation. The Islamist threat the politicians now frequently discuss appears much less likely as a source of destabilisation of the region than reckless actions on the part of the United States.

Then there is, of course, the economic situation in both the Transcaucasus itself and in the Caspian states of Central Asia. As we see it – and the economics experts are warning of this more and more often – the oil and raw material boom of the last few years has engendered a certain euphoria regarding the economic prospects of the Caspian states, but this may prove to be short-lived. Let us focus on two key aspects. On the one hand, extraction of oil and gas in the region is growing fast at the moment, but in Azerbaijan and Kazakhstan, and partly in Uzbekistan and Turkmenistan, this growth is based on bringing on line new deposits where development was launched in the mid-1990s and design capacity will be reached in 2010-2012. From that time onwards, the rapid growth of extraction may be replaced by stabilisation, which could suspend the increase in exports. Considering that budget expenditures in all the Caspian countries went up by 30- 40% per annum from 2002 to 2007, such a situation might lead to a wind-down of a number of ambitious economic projects. We therefore believe that the main task facing the government of Azerbaijan today is to increase the population's real incomes and solvent demand and to establish branches of the economy orientated towards saturating the national market. On the other hand, it is already noticeable that the economic growth in all the Caspian countries has been based not only on an influx of revenues from raw material exports, but also on large-scale foreign investments – in the form of both actual investments and loans. Over the last two years alone, the debts of private companies and banks not guaranteed by the state have risen in Azerbaijan from \$6.5 to \$9.5 bln. and in Kazakhstan from \$29.5 to \$66.5 bln<sup>7</sup>. These figures now top the official gold and currency reserves of the Central Banks of Azerbaijan and Kazakhstan by 50 per cent. Moreover, local banks are rapidly expanding consumer lending, creating a rise in demand among the population.

From 2000 through 2007, the sum of consumer loans extended by Azerbaijan's banks went up 14.2-fold and by Kazakhstan banks – 41.1 times<sup>8</sup>. In this situation, the limited nature of credit resources might act as a serious restraining factor on economic development: it is no secret that Kazakhstan's economy encountered just such problems already in the second half of 2007 and the beginning of 2008: the GDP growth rate dropped from 8.5% in 2007 to an anticipated 2008 year-end 5.3%; many banks came up against the problem of capital inadequacy, share prices fell, the housing and commercial real estate markets plummeted 40-50% in value and growth in the construction and investment spheres was replaced by a fall in the volume of new construction capacity. The authorities of Azerbaijan must carefully avoid such a turn of events, since investor confidence is slow to be restored and, in our opinion, moderate though stable growth rates are far preferable to a boom, which will inevitably be overtaken by some form of crisis.

In spite of all the economic successes of recent years and the substantial revenues from energy resource exports, Azerbaijan remains a relatively poor country with an average per capita GDP of \$3,633 thousand. Under these conditions, the main focus should be on forming long-term sources of currency revenues (above all from increasing extraction of energy resources and organising a full processing cycle for them, as well as establishing a leading role in transit by oil and gas from the countries of Central Asia to Turkey and Europe) and diversifying the economy by developing sectors geared to the domestic market. Azerbaijan today has all it needs for implementing a strategy of comprehensive development of the country and increasing the people's prosperity. Yet, for this purpose, the country's authorities must pursue their political line subtly and consistently in order to avoid becoming hostage to any of the great powers, with their own strategic interests in the Caspian region, being drawn into escalation of regional conflicts and succumbing to the illusion of the possibility of rapid economic growth based on credit market "bubbles".

## Conclusion

At the beginning of the 21st century, Azerbaijan is uniquely placed in geopolitical terms as, at one and the same time, a state that is a major supplier of energy resources to the world market and a country that has the possibility of controlling transit of oil and gas extracted in Central Asia to the markets of Western Europe. This leadership, formed as a result of the actions of neighbouring countries (not last among them Russia, which in recent years has exerted strong pressure on the energy sphere in Kazakhstan and particularly Turkmenistan), rather than as a consequence of the policies pursued by the country's leadership, needs to be transformed into a strategic advantage over the coming 15-20 years – first of all by organising efficient and large-scale transit from Central

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<sup>7</sup> See: Andrei Zlobin, "Eyes on the crisis" in: *Smart Money*, No. 25 (115), 14 July 2008, p. 59.

<sup>8</sup> See: Graham Turner, *The Credit Crunch. Housing Bubbles, Globalisation and the Worldwide Economic Crisis*, London, Ann Arbor (Mi.): Pluto Press, 2008, p. 133

Asia and further development of the oil and gas complex on the basis of active involvement of foreign technologies and investments. It is vitally important for Azerbaijan for the “southern” (trans-Caspian) transit to become, in the next few years, preferable and more beneficial for the Central Asian countries than the “northern” (Caspian area) transit. This will result in a focus on the European Union and the United States rather than Russia and China – yet this choice, however dramatic it might be, is in the long-run geopolitical interests of the Republic of Azerbaijan.

At the same time, Azerbaijan’s leaders must, for a while, give up attempts to reintegrate the breakaway Karabakh territories into the country. The next few years will be so critical for establishing Azerbaijan’s new economic paradigm that it will be impossible to resolve both economic and military-political problems at the same time. In this respect, we consider the way China has co-existed for decades with virtually independent Taiwan as the optimum variant. Azerbaijan must, while striving for a political solution to the Karabakh problem, show, by means of its economic development, the advantages of a reunited multi-national state over a separatist future for Karabakh. Attempts to restore Azerbaijan’s unity by force, however deplorable this might sound, will not today be crowned with success, while they might undermine fundamentally the country’s economic development potential. Political stability in the Transcaucasus is the greatest asset for Azerbaijan as an oil extraction and transit state and this stability, even in the Karabakh case, which infringes on the Azerbaijan people’s patriotic feelings, should be appreciated and no attempts be made to disrupt it.

Finally, the main task facing the authorities of Azerbaijan is to form a comprehensive modern economy in the Republic, one that is not fixated on the oil extraction industry. All sectors of the economy should be developed, focusing particularly on the industrial sector: oil-refining, the chemical industry, machine-building and consumer goods manufacturing – for the needs of the country’s own populace and for export to neighbouring states. The experience of Turkey, which, over a period of thirty years, has been transformed from a backward, agrarian country into a modern industrial economy, should serve as an example for independent Azerbaijan. Imports of technologies, borrowing of production strategies and exchange of personnel with Turkish companies could determine a long-term trend of development for Azerbaijan’s economy (which is particularly topical, considering the cultural affinity between these two Turkic peoples and the strengthening foreign trade links between Azerbaijan and Turkey).

Azerbaijan is only a small country, but one that has found itself “in the right place at the right time”. All that remains is to wish that its current and future leaders become great reformers and turn this country, which was relatively poor when it obtained independence, into the Transcaucasian equivalent of Singapore or Taiwan. The conditions are all there; only the future will tell whether such ambitious plans are to be realised.