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THE IMPORTANCE OF NATURAL RESOURCES FOR THE AZERBAIJANI ECONOMY

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Abstract

Azerbaijan's natural resources attract the transnational corporations from the developed world and increase investment projects in oil industry. The development of the petroleum industry has significantly increased the GDP of the country since 1994. The paper will focus on natural resource contracts. Their impact on GDP growth, oil industry, and regional economic integration will be described through two important contracts. While all assistance is welcome from oil corporations, the paper claims that the Azerbaijani Government must consider disadvantages of oil and gas exploration projects, because the negative results can impede upon the country's economic development in a long run. Descriptive explanatory discussion method is used in this research paper by referring to the information from works of scientists and organizations. The goal of this paper is to show that Azerbaijan currently benefits from investments of oil corporations, but may suffer negative consequences in a long run as observed in other oil-rich, post-Soviet countries. There is a suggestion that it may be possible to predict those problems and make new efforts in order to prevent the state from facing economic stagnation in the future.

Keywords: *Azerbaijan, Oil industry, Contracts, Corporations, Investment.*

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1. INTRODUCTION

The investments and the projects of the transnational corporations in the oil industry have had both positive and negative consequences for the former Soviet Union countries. Although the oil-rich developing countries benefit a lot by attracting corporations from the developed world, there can be negative effects for countries depending on their institutions, geographical locations and so forth (Bannon & Collier, 2003).

Azerbaijan established its freedom in 1991, and attracted transnational corporations for the exploration and production of its natural resources. Due to the natural resources of Azerbaijan, transnational corporations did play important roles in the country's economy and the region's economic integration through huge investment projects. The unemployment and the poverty in Azerbaijan were reduced significantly because of the financial resources received through the oil projects. Two main contracts, such as "Contract of the Century" and "Contract of the 21st Century" induced significant changes in the economic system of Azerbaijan and, especially, in the petroleum industry. These contracts opened new opportunities for the country to export its natural resources to the global market. The trade of the oil and gas resources increased the GDP dramatically since 1997. The GDP has increased from around 3 billion USD (1995) to 75 billion USD (2014) (World Bank, 2021).

Azerbaijan will face serious economic problems in a long run if the government does not implement new reforms in order to reduce the GDP dependency on the petroleum industry. Despite the fact that poverty reduction (5% in 2018 (ADB, 2021)) and decreasing unemployment rate (6% in 2020 (World Bank, 2021)) are the significant accomplishments in the last decade; the government's regional socio-economic development program was insufficient for the economic diversification.

Azerbaijani economy heavily dependent on oil revenues, and commodity price volatility affected the economy negatively since 2014 due to plummeting oil prices. Oil wealth of Azerbaijan allowed the government to support and improve living standards of people mainly before 2014. However, the reliance of whole economy on oil sector threatened the economy's fiscal balance and stability. Economy's dependence on the export of natural resources may affect the country's economy negatively and induce slow growth: a phenomenon that's considered as the resource curse theory. The resource curse explains that countries which are rich with natural resources perform much worse than the countries without resources (Humphrey, et al., 2007; Barma, et al., 2011).

The research paper acknowledges the transnational oil corporations' contributory roles in the economic system of Azerbaijan because they were the primary financial sources for the country to advance its economy in a short run. The financial resources were used for the investment projects in various economic sectors such as petroleum industry, construction, and transportation. Furthermore, the paper's objective is to focus on Azerbaijan's economic performance in order to show that the symptoms of the resource curse might be noticeable in Azerbaijan, and the government should consider it seriously. The problems in the non-oil sector show that the government should focus on this sector for eliminating serious problems in a long-run. The macroeconomic instability and the dependence on the export of the crude natural resources are the problems and should be taken into account. The financial resources from the petroleum industry and the GDP growth are the useful tools for the government to achieve the progress in the non-oil sector.

The paper through explanatory discussion will refer to the information from previous studies as well as international organizations and illustrate the consequences of the oil projects which are implemented in Azerbaijan since 1994. In this section, the paper will analyze two major contracts, which played significant roles in developing the economic system. These accomplishments include the reduction of unemployment and poverty, international economic integration and the relations with the developed world. Descriptive method is used for the entire paper, and the legislative acts, works of the international and national scientists related to the topic, information from the World Bank and the Statistical Committee of the Republic of Azerbaijan are the important information sources in order to support the research through descriptive discussion. Ultimately, the author will demonstrate the urgency for achieving high economic growth in other non-oil sectors in order to overcome the stagnation of the economic system in a long run.

2. HISTORICAL BACKGROUND

Azerbaijan's oil resources were described in the works of the authors since the ancient times. The petroleum industry was not developed till the 19th century as oil was used for medical, military etc., purposes. The 19th century was the turning point in Azerbaijan's economy due to the development of the oil industry. Russian, Swedish, German, and other companies opened their branches in the capital city of Baku, for investing in the economy and extracting the natural resources. Famous companies like Anglo-Russian Oil Company, Trade House Benkendorf and Co, The Russian Oil General Corporation, Branobel, Royal Dutch Shell, De Rothschild Freres and so forth explored and traded Azerbaijani oil to the worldwide

marketplace in 19th-20th centuries (Hasanov & Bahramov, 2014). As the capital flew into the country since the 19th century, new techniques for oil exploration and extraction were developed and, afterwards, Baku became one of the famous industrialized cities in the world by producing almost 50% of the world's oil.

The following stage of the petroleum industry began after the occupation of the USSR at the outset of the 20th century. Azerbaijan supplied around 75% of its oil resources for the Soviet Union in World War II (Narimanov & Palaz, 1995). New oil wells were explored after constructing the city of "Neft Dashlari" on the Caspian Sea in 1949 because the city generated a significant amount of profits and created an advantageous environment for the scientists in order to explore, extract and produce the natural resources in the Caspian Basin.

The next stage of the oil industry covers the independence years of the Republic of Azerbaijan since 1991. The "Contract of the Century" in 1994, established a successful environment for the transnational corporations such as British Petroleum, Lukoil, Chevron, Ramco, Statoil, and etc. They invested huge financial resources in the petroleum industry, and extracted and traded the Azerbaijani oil and gas resources in the global market. Moreover, the "Contract of the 21st Century" which was signed in 2013 will help Azerbaijan to be the significant gas exporter as well. The government changes its strategies and policies related to oil industry due to the diminishing oil production and, additionally, the gas industry is believed to be the new stage in Azerbaijan's history.

3. LITERATURE AND DISCUSSION

There are many achievements were made during the country's independence years, in spite of the disadvantages of the ongoing oil and gas exploitation in Azerbaijan. The transnational corporations are in the center of those achievements because of the income growth, decreasing unemployment rate, poverty reduction and increasing investments in the non-oil sector of the economy. A number of national and foreign researchers state that the transnational corporations have significant positive impacts on the economic development of Azerbaijan. Azerbaijani scholar, Kazimov (1999) argues that transnational corporations allow Azerbaijan for better economic integration and relations with the developed world, which potentially helps to turn the attention of other countries to Azerbaijan. His positive claim is supported by the fact that "Contract of the Century" increased Azerbaijan's role in globalization because transnational corporations from more than 40 countries invested in the country, which moved the market-driven economy to the new stage by carrying out new

reforms. Inheritance of the planned economy and the communist ideology from the USSR are the main reasons which drag the economy from growing faster than it is designed for a short-term period. The war in the western part of the country created destructive consequences for the country's economy. So, the reasons which are mentioned above are the main arguments for the stagnation of the economy. Thus, unlike other oil-rich Central Asian countries, transnational corporations' presence in Azerbaijan brought stability to the region and created new opportunities for the developed world to tighten relations with the country.

Nevertheless, the non-oil sector of the economy has stagnated in the recent decade due to the slow diversification of the economic system. The reasons for the negative consequences are not connected to the corporations' investments but mostly tied to the problems within the government such as corruption, lack of transparency and so forth (Rosenberg & Saavalainen, 1998). Some authors (Auty, 1993; Van der Ploeg, 2011; Ross, 2012) argue that the corporations' rapid exploitation of the natural resources might show negative consequences related to long run economic stagnation, environmental pollution, and etc., which are observed in the former Soviet Union countries. Since many of those countries have different institutions, cultures, political systems and geopolitical locations, there are also different impacts of the foreign investments. The contracts and agreements with transnational corporations are the "key tools" of the economic development of Azerbaijan and international economic integration. To support these notions, the paper will turn its attention to several major contracts and projects after describing the characteristics of the transnational corporations.

The stagnation in the non-oil sector has increased because few policies were made for attracting foreign direct investments to agriculture, transportation and so forth. The oil and gas industry still dominates in the economic system because most of the foreign investments flow into this part of the economy (Rosenberg & Saavalainen, 1998). Azerbaijan will benefit from its natural resources within a short run, so the speed of economic diversification should be increased in order to evade the long run stagnation of the economy (Ibadoglu, 2008). The data and information from the Central Bank of Azerbaijan (2021) and Statistical Committee of the Republic of Azerbaijan (2021) show that Azerbaijan has made achievements in terms of GDP growth. The primary reason is considered to be the transnational corporations' oil projects in the Caspian Basin. New reforms are needed for solving the problems of the non-oil sector of the economy related to agriculture, transportation and so forth.

Some scholars emphasize that Azerbaijan will become one of the main gas suppliers for the European Union. In an article by Thomas de Waal (2013), it is indicated that natural

resources are still the most powerful facets of the country's economy. Although the oil production is going to decrease, gas exports will determine the country's future. TANAP¹ (Trans Anatolian Pipeline) and TAP² (Trans Adriatic Pipeline) projects are supposed to be the most powerful forces in the economic field, international relations with the EU and regional economic integration. Moreover, Nick Snow (2013) is also optimistic about projects and agreements between the Azerbaijani government and the transnational corporations. He states that the TAP and TANAP projects are important for increasing Europe's energy security and expanding global markets. The investment projects develop the countries in the Caucasus region such as Azerbaijan and Georgia. He argues that the gas projects are the significant elements for Azerbaijan for building and pushing the economic growth as well as developing relations with the European Union member states. For Azerbaijan, economic growth and development are essential for getting out of the heritage of the transition economy (Esanov, et al., 2001). Azerbaijan will be a key factor for maintaining Europe's energy security as a gas supplier in future.

The authors and reports which are mentioned above have claimed that transnational corporations' projects for the exploration of the oil and gas resources in the Caspian Basin are one of the most effective and positive methods for uplifting Azerbaijan's status in a global market as an oil and gas supplier, and this fact is undisputed by the author of this paper. However, there are also negative effects of the projects for the economy in a long-run due to the increasing gap between the oil and non-oil sectors of the economy. Azerbaijan can face similar serious consequences, which are observed in the post-Soviet Central Asian countries. So, new important reforms and steps should be taken in order to achieve macroeconomic stability in a long run.

3.1. Advantages and Disadvantages of Transnational Corporations' Projects in Azerbaijan

As the author mentioned before, transnational corporations were the important factors for the international economic integration and Azerbaijan's influential economic status in the global market. The investment projects created a successful business and economic environment for the domestic market as well. There might be negative impacts of the continuous oil projects in a long run as well due to the lack of the government reforms and

¹ TANAP (2021). Trans Anatolian Pipeline. Retrieved from <http://www.tanap.com/>, [Accessed: 20th May 2021].

² TAP (2021). Trans Adriatic Pipeline. Retrieved from <https://www.tap-ag.com/>, [Accessed: 20th May 2021].

regulations in the non-oil sector. A vital question that must be raised is whether the transnational corporations from the developed world have provided only positive effects on Azerbaijan's economy during its independence since 1991. More specifically, what have been the advantages of the corporations' investments on the development of economic sectors of Azerbaijan? Moreover, to what extent the government uses the financial resources to benefit the people in Azerbaijan?

One of the most effective evidence to support the research project lies in statistical data and information received from several organizations such as World Bank (2021) and the Statistical Committee of the Republic of Azerbaijan (2021).

3.1.1. "Contract of the Century" and "Contract of the 21st Century"

The history shows that petroleum industry has played an important role in the economic system of Azerbaijan during 19th-21st centuries. "Contract of the Century" in 1994 was the turning point in Azerbaijan's history and economy because the contract recovered the economy right after the costly war with Armenian and Russian allied troops, in which the country lost the lands and obtained around one million refugees and internally displaced people. The collapse of the USSR was another problem that Azerbaijan faced due to switching from planned to market economy by entering transition economy status.

The contract saved Azerbaijan from disastrous economic and political situation because almost all aspects of the economy have changed after the agreement with the corporations. By signing the contract, around 13 transnational corporations and nine countries started huge projects because there were a lot of unexplored lands with lots of oil and gas resources. Afterwards, the contract led to other agreements with more than 15 countries and 40 corporations.

"Contract of the 21st Century" opens new chances for Azerbaijan to export its gas resources from "Shah Deniz 2" field to Europe through TANAP (Trans Anatolian Gas Pipeline) and TAP (Trans Adriatic Pipeline) projects and, hence, the country faces new opportunities in terms of regional development, close relations with the European Union and etc. TANAP and TAP projects are the main factors for connecting Azerbaijan and Europe in terms of successful economic and political relations and energy security.

Unlike some Central Asian countries, such as Kazakhstan and Turkmenistan which share similar economic and political problems after the establishment of their independence (Olcott, 1998; Bohr, 2016), Azerbaijan did not face such serious problems during the last

decades. Savin and Ouyan (2013) stated the following:

Post-Soviet Central Asia suffers from the threat of a host of turbulences of diverse origins: localized conflicts, uneven economic distress, drugs and arms trafficking, environmental disasters. Ethnic tensions, in particular, simmer beneath many “fault lines”, leaving the region susceptible to instability and encroachment of forces that have root in “separatism, radicalism, and extremism”. Akin to the shadow of the classical tournament this region is now plagued by tensions arising from increasing power buildup, both within and beyond.

So, continuous conflicts and political instability drag the development of the economy of the oil-rich post-Soviet countries in Central Asia (Jones & Weinthal, 1999). Those problems weaken their economic systems; hinder the Central Asian countries from achieving macroeconomic stability. Azerbaijani government was quite successful in addressing the problems related to the petroleum industry, and achieving progress in the economic system in a short period of time. The above-cited authors addressed the following related to Azerbaijan:

Azerbaijan, on the other hand, managed to involve more US interests in prospecting and drilling of hydrocarbon resources immediately after independence. Due to its unique geographical location, Baku has to a large extent been insulated from the frictions between Kremlin and its Central Asian junior brothers on the issue of routing of pipelines. There is also an added advantage; it has accumulated century old experiences in hosting foreign ventures, both on land and offshore, in commercial excavation of oil, thus contributing to rapid depletion of unexplored reserves (USEIA 2014).

Pervasive corruption problems in some of the oil-rich Central Asian countries show that the lack of new reforms is the reason for the slow development of the economic systems. New reforms and institutional changes are always needed in order to diminish the problems related to corruption and economic stagnation. The situation related to the transparency and corruption in the energy sector is different in Azerbaijan. Jaffe (1998) stated the following about Azerbaijan after signing the oil contract in 1994:

In Azerbaijan, for example, the International Monetary Fund (IMF) ensured that oil exploration contract signing bonuses sent into a special account at the Central Bank be fed into the national budget on a predetermined, staggered schedule. Before energy exports begin to take off in large volumes, it would be useful for Caspian governments, local authorities, the energy industry, and international financial institutions to assess prospects for the establishment of social equity funds and business partnerships. Both instruments could be part of a broader strategy to strengthen the internal cohesion of states through internal wealth redistribution and conflict resolution, promote interstate cooperation and

encourage long-term stability. (p. 23)

The corruption and transparency issues in the energy sector are thoroughly controlled by the international organizations in Azerbaijan, and this creates better business environment for the transnational corporations in the petroleum industry. Afterwards, the transnational corporations were quite successful in implementing the projects. The government is highly concerned about the corruption problems in the oil industry, as it is the main income source for the economic system. Despite the fact that the corruption in the oil industry is decreased significantly, the non-oil sector suffers from the corruption and the lack of transparency (Chene, 2013). Although Azerbaijan scores below the average in terms of corruption, the country has improved the score significantly compared to the last decade. New strict measures should be imposed in order to diminish the level of corruption and advance the non-oil sector.

The conflict in the Western part of Azerbaijan negatively affected all aspects of the economic system and decreased the GDP until around 3 billion USD (World Bank, 2021). Nevertheless, unlike other Central Asian countries, the investments of transnational corporations helped the government to attain the macroeconomic stability in a short run and achieve dramatic GDP growth (75 billion USD in 2014) (World Bank, 2021). The oil pipelines going through Georgia and Turkey are the key factors for exporting Azerbaijani oil and gas resources to the global market. These pipelines are also significant elements for advancing the economic integration with other countries.

The Azerbaijani Government achieved its short-run goals related to poverty reduction and socio-economic development of the regions by signing “Contract of the Century” in 1994. Despite the fact that the country still struggles for boosting the non-oil sector and decreasing the corruption level, the achievements which were made during the independence years attracted more corporations in recent years because unlike the Central Asian countries, Azerbaijan developed faster and created better business environment for the international companies.

The new contract which was signed in 2013, the “Contract of the 21st Century” will enable Azerbaijan to transfer its natural gas to Europe and enhance the relations with the European member states. The decreasing rate of the oil production (USEIA, 2014) induces the Azerbaijani government to take serious measures towards achieving its long-run macroeconomic goals, which depends on future gas exports. Gas exports will be primary elements for the money supply and economic diversification. The “Contract of the 21st

Century” is the significant factor for the implementation of the new gas projects.

Will the “Contract of the 21st Century” be successful in terms of achieving the macroeconomic stability and the economic diversification in a long run? What will Azerbaijan gain after the implementation of the TAP and TANAP projects?

Due to the achievements in the oil industry, the Azerbaijani government and the EU states are optimistic about the future of the projects and gas transfers to the European market. Azerbaijan becomes one the important factors for the energy security of Europe. Shahin Abbasov (2014) addressed the following:

Compared with Russia – in 2013, the world’s second-largest gas producer (668 bcm) after the United States – Azerbaijan is not “a proper alternative for Russian energy sources,” but already, it is “a major point in Europe’s efforts to decrease its dependence on Russian gas, commented Elhan Shahinoglu, head of Baku’s non-governmental Atlas Research Center.

Russian presence in the Caucasian region was a huge obstacle for Azerbaijan during its independence years, and the Azerbaijani government was quite successful in signing the contracts and implementing reforms. The new contract is a significant factor for both Azerbaijan and the EU for the facilitation of the energy security in a region. Aliyev Ilham (2013) (The president of the Republic of Azerbaijan) stated the following, concerning the “Contract of the 21st Century”:

Energy policy, close cooperation with international institutions and diversification and transparency are among the key elements of successful development. I believe that Azerbaijan has not caught the "oil disease", so-called "Dutch disease". We are an example of how oil and gas should serve the interests of the people. Of course, one of the main prerequisites for this is international cooperation. We appreciate this cooperation as the knowledge and experience of foreign companies are very important to us.

What were the major disadvantages of the corporations’ projects in the petroleum industry of Azerbaijan?

One of the problems was connected to the health problems of the people who lived in the villages close to the pipeline. The transnational corporations were not concerned about the health issues of the people. People who lived close to the pipelines did not have enough money for visiting the hospitals due to the extreme poverty during the construction of the BTC pipeline. The cause of the health problems was the environmental pollution close to the

pipeline construction, which worsened the living conditions of the people living in the area (Kochladze et al., 2005). The first problem was the removal of the huge amounts of trees alongside the construction. Apart from the environmental damage, the BTC Co. was dealing with sales of timbers removed from the construction area and, thus, the corruption in timber business was increased. Water contamination was another problem, which affected people's lives in the construction area. People's worsened health conditions and environmental damages were the major disadvantages after the construction of the BTC pipeline. The pipeline is the important factor for exporting Azerbaijani oil to the worldwide marketplace, but the environmental and health damages should also be taken into account. The construction of the pipeline did not only harm Azerbaijani people but also Georgian and Turkish people as well.

The unbalanced development of the economic system is creating a negative situation for Azerbaijan. Unregulated dependency on crude oil and gas exports poses great risks for the country due to the shortage in other economic sectors. The concentration of the economy on the petroleum industry has a significant effect on the macroeconomic stability (Rosenberg & Saavalainen, 1998). Thus, it can easily affect the macroeconomic stability in Azerbaijan due to the changes in the oil prices in the global marketplace. The slight changes in the petroleum industry worldwide will affect the whole economic system in Azerbaijan.

Azerbaijan's dependency on energy resources makes the country vulnerable to the external factors such as the changing oil prices and the production level. The government needs new institutional reforms in order to diminish the vulnerability of the economic system towards the external factors. The decreasing oil production drags the economic growth because the crude oil and gas resources are supposed to be the primary elements of the GDP growth.

In order to prevent the difficulties in a long run, the Azerbaijani Government should make some changes related to the monetary and the fiscal policies. The government should try to balance the sources of the money supply in the economic system by increasing the role of the non-oil sector.

4. CONCLUSION

The author realizes that transnational corporations and their projects have had positive impacts during the 20 years of Azerbaijan's independence. Even though the first contract had some negative results related to people's health, environmental pollution, and etc., the GDP

growth, the poverty reduction and successful relations with the developed countries improved Azerbaijan's image in the international arena. Azerbaijan has increased its efforts in improving the transparency in the energy sector in spite of the corruption problems.

Due to having received continuous financial resources from the projects, the Azerbaijani government is continuing to suffer from the increasing gap between the sectors of the economic system, which mainly depends on the petroleum industry. Macroeconomic stability can be affected easily because of the changes in the oil prices, as the economic system largely depends on the petroleum and gas industries.

Another problem discussed in the paper was corruption, which is rampant in post-Soviet Union countries. The corruption did not affect the energy sector that much due to the improved transparency. Yet, other sectors suffer from corruption, which hinders the foreign corporations from investing in other sectors of the economic system. The transnational corporations are not responsible for the increasing level of corruption in other sectors, and the government should make important steps for diminishing the corruption level in order to develop other sectors.

Azerbaijan is open to the investments from the developed countries. Most of the resources are invested into the petroleum industry and, hence, this hinders the diversification of the economy in a long run. To maintain the diversification of the economic system, and to block the negative impacts of the transnational corporations, it is important to the Azerbaijani government to carry out the alternative reforms for diminishing the dependency on the oil industry and achieving economic growth in the non-oil sector.

No development is possible in the oil-rich post-Soviet transition countries, without harming some other aspects tied to the environment and the non-oil sector. The assistance from the corporations in a short run is enough for Azerbaijan to facilitate the reduction of the corruption level and diversify the economy. It is well understood from the paper that, for a long run, the economic stagnation in Azerbaijan is not connected to the projects of the corporations. The government is responsible for the problems because there were not enough reforms for developing other sectors of the economic system. The socio-economic regional development programs were successful; still, the non-oil sector has a small share in the development of the economic system.

Finally, the transnational corporations' projects and agreements in Azerbaijan were quite beneficial for the country due to the accomplishments, which are connected to the poverty and the unemployment reduction. The corporations played important roles in

Azerbaijan's increasing role in the global market and increasing the transparency in the energy sector. Nonetheless, the government should be careful about the long run economic problems, which are prevalent in other oil-rich Central Asian countries. It is the hope of the author that this research paper is the simple step in order to bring attention to this reality in Azerbaijan, for overcoming the future stagnation of the economic system.

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