

## State Oil Company of Azerbaijan Republic in Turkey: Long-term strategic and economic interests

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**Abstract.** This research paper looks at how the State Oil Company of Azerbaijan (SOCAR) has been expanding its operations abroad, with a particular focus on the recent investments in Turkey. Empirical data on the investments of SOCAR is embedded in the theoretical discussions on the interlinkage between the interests of states and the oil companies, shedding light on what benefits investments abroad bring in for the country of origin of the companies as well as the host countries. Among others, it is an important question to ask how the oil companies contribute to their country of origin both in terms of strategic and economic interests.

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### 1. Introduction

Energy resources are the backbone of Azerbaijan's economy. And SOCAR is mainly responsible for the production and transportation of these resources. Apart from meeting domestic demands on energy resources, SOCAR also deals with exports. The company has been expanding its operations abroad since its foundation in 1992. After the collapse of the Soviet Union, Azerbaijan had to take important measures to adjust its oil industry to make it in line with the demands of global value chain (GVC). In other words, the country had to move from a simple energy supplier to the Soviet Union into becoming a part of GVC which requires complex labor and inter-firm coordination. And to become a part of the GVC, beside making necessary adjustments, SOCAR was obliged to stick to global standards.

In this article, firstly theoretical discussions on the interlinkage between the states and the oil companies, and what benefits the latter ones bring about in terms of economic and geostrategic interests. Then a brief information about the history of SOCAR and oil industry in Azerbaijan is provided. And then, SOCAR's investment expansion abroad, in particular in Turkey, is explored and finally it has been discussed what strategic and economic interest are behind such investment in long term.

### 2. Interconnection between oil companies and states

Ownership patterns in the Oil and Gas Industry show that the state is the dominant player. However, the exact relation between a regime and the oil industry is complex. Saudi Arabia, for example, is closely linked to the oil industry---in fact, it could be

argued that Saudi state policy is centred around oil. Ever since Ibn Al Saud, the founder of the Saudi kingdom, allowed US companies to prospect for oil within the Kingdom in 1933 the Saudi regime has been closely linked to the United States. In a remarkable study, Irvine Anderson examines the years between 1933 and 1950 looks at how closely U.S. foreign oil policy and the Saudi monarchy are linked (Anderson, 2014). The Saudi monarchy has been closely linked with the West ever since Ibn Saud gave up sovereignty, in return for protection, to Britain in 1915. While the imperial power has changed, the role of oil continues to be the dominant, if not the only factor in Saudi policy. And also, domestically, the Saudi government has used projected oil revenue to build the kingdom (Vitalis, 2009: 6).

In Russia, another major oil producer, state politics support and help Gazprom, but is not the only dominant factor in Russian politics. Russian state support of Gazprom is evident in pipeline politics in Europe. Relations with Europe are much more complicated than merely following the interest of oil. Oil dominates the Russian economy and provides the state with a comfortable rent that allows it to pursue other strategic and domestic goals. Revenue from oil also supports other Russian industries and the states largesse towards its citizens (Gustafson, 2012). Though energy and oil are just one factor in Russian international politics, energy policy is closely associated with foreign policy and Russian geopolitical policy can best be understood when energy and foreign policy is studied together Russia sees energy as a tool in enhancing its power. Energy is a crucial component of Russian strategic thinking, but not the only factor (Dellecker and Gomart, 2011, Kustova, 2013).

China is similar in that energy policy is a crucial component of foreign policy. However, due to its booming economy, it is more instructive to see China as an energy importer than a country that is reliant on raw material. Therefore, secure energy supply, rather than the ability to export energy, is the key element in China. In addition, the tremendous growth of Chinese demand for energy has enormous impact on issues of sustainability, the environment, and the domestic organization of energy policy and supply (Romano and Meglio, 2016).

The United States and France are similar except that the oil industry is in private hands in the United States, and the relation of France to the oil industry is similar to the one that the United States has with its oil companies. Energy policy is a factor, but not the only factor. For example, the access of France to Iraqi oil was a major factor in Franco-Iraqi relations. France, however, saw this in relation to several other factors—whether France should have exclusive access to Iraqi oil, or if it should act in concert with other powers. This was a major component of energy policy in the Fifth Republic (Styan, 2006: 69).

Oil companies are closely related to the government in the United States and the United Kingdom. While state oil companies are directly under the control of the regime, private companies such as ExxonMobil and British Petroleum have tremendous influence on policy making. It is dependence on oil that makes the United States one of Saudi Arabia's closest allies and it was nationalization of the Iranian oil industry by Mossadegh in 1953 that led to a CIA sponsored coup to overthrow him (Keohane, 1982).

In other countries such as Venezuela energy policy is more domestic. This is especially true in countries where oil accounts for a major part of the GDP and form the bulk of the exports. Several countries are major contributors to the GDP in several countries. Fuel accounts for more than 90% of total exports in Algeria, Azerbaijan, Brunei Darussalam, Iraq, Kuwait, Libya, Sudan and Venezuela. (Hutt, 2016). Oil revenues have been used by regimes to gain support. For example, oil prices play a major role in President Vladimir Putin's grip on power in Russia, (Maugeri, 2014) while under Hugo Chavez, Venezuela used oil revenue to expand social spending (Gott, 2011).

Oil companies in general play crucial role in carrying out energy politics of their country of origin. In this respect, SOCAR's investments cannot be considered separate from Azerbaijan's foreign policy in general, and energy policy in particular.

### 3. Brief history of SOCAR and oil industry in Azerbaijan

SOCAR was established as a state-owned company in 1992 on the foundation of Azerineft State Concern and Azerneftkimya Production Association. The tasks of SOCAR include exploration, production, processing and transportation of oil and natural gas. It deals with supplying natural gas to domestic customers and the industry. SOCAR is in hold of operation of two oil refineries and, it owns onshore and offshore production divisions in the country (SOCAR official website 2017).

It is worth to note that since the signing of 1994 'contract of the century'<sup>1</sup> in September 1994, SOCAR has been collaborating with the consortium of transnational oil companies (known as Azerbaijan International Operating Company – AIOC), including BP, Exxon, Lukoil, TPOC etc., to explore offshore oil fields of Azeri, Chirag and Gunashli in the Caspian Sea (Nasirov, 2010). Entrance of transnational oil companies (TNOCs) into Azerbaijan has revived the oil industry in the country; this was reminiscent of the end of the 19th century when Baku attracted an enormous amount of industrial investment from all around the world. TNOCs brought in new technologies and expertise. This boosted Azerbaijan's oil production once again. It is important to note that one point in the history Baku was leading for the oil production in the world. In 1890 with almost 98%, Baku was the major oil provider for the Russian Empire. Moreover, by 1901 Baku was supplying half of the world's oil output (Ciarreta and Nasirov, 2010, p.2). Azerbaijani oil played a major role in World War II. In 1941 the country supplied nearly 23 million tons of oil, which was at the time almost 75% of the overall oil production of the Soviet Union. After the World War II oil production in Azerbaijan sharply declined, mainly because the Soviet leadership focus on oil production in other parts, e.g., Siberia and Urals, of the Union. In 1970 Azerbaijani oil production, which was 20 million ton per year, met nearly 6% of the Soviets oil demands and this number even decreased to 2.4% in 1980 (Ciarreta and Nasirov, 2010, p.2). In mid 1990s just on the eve of signing of the contract of the century Azerbaijan was producing 10 million tons of oil per year, which is almost 4 times less than today's production level.

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<sup>1</sup> On 24 September 1994 Azerbaijani government signed a contract, which became known as contract of the century, with a number of foreign oil companies – BP, Amoco, Exxon, Pennzoil, Ramco, Statoil – in order to develop the offshore oil fields of Azerbaijan jointly. Some other foreign oil companies such as Lukoil and Itochu had joined the consortium. See Nasirov, E. (2010).

Since 1997 with the operations of AIOC the oil production started taking off again in Azerbaijan. In 1997 Azerbaijan produced 180,000 bbl/d, but production reached almost 800.000 bbl/d in 2007, nearly 41 million tons. (Azerb.com, n.d). As seen from the Table 1, Azerbaijani oil production peaked in 2010 at nearly 51 million tons per year. Taking a look at the last ten years' oil production in Azerbaijan and SOCAR's contribution in this regard, it is clear that SOCAR has been producing nearly 20% of Azerbaijan's oil.

**Table 1. Oil Production in Azerbaijan (in 1000 t.)**

Year	SOCAR	AZERBAIJAN
2017	7427.1	38688.9
2016	7522.4	41034.5
2015	8160.5	41586
2014	8320.4	42022.7
2013	8314.9	43483.9
2012	8289.8	43389.8
2011	8400.9	45625.4
2010	8459.7	50795.5
2009	8543.3	50419.3
2008	8651.3	44527.2

Source: SOCAR. (2018).

SOCAR has also gained important experience in natural gas production. As presented in the Table 2 below, SOCAR has been producing 6-7 billion cubic metres (bcm) of natural gas, accounting for in the range of 20 to 30% of overall production in Azerbaijan for the last 10 years.

Azerbaijan historically has been an oil producing country. Yet, recently the country also became a natural gas exporter, thanks to the Shah Deniz gas and condensate fields which became operational in 2007 (Jafarova, 2014). Major natural gas exploration is expected to be boosted with the implementation of the Trans-Anatolian (TANAP) and Trans-Adriatic (TAP) gas pipeline projects. Azerbaijan already uses the South Caucasus Pipeline (SCP) to transport its gas from the Shah Deniz I field via Georgia to Turkey. Shah Deniz II is projected to feed natural gas into the TANAP pipeline and via a TAP connection into Europe. In its final stage, it is expected to be 31 bcm per year by 2026 (Hürriyet Daily News, 01 October 2016).

**Table 2. Gas Production in Azerbaijan (in million m<sup>3</sup>)**

Year	SOCAR	AZERBAIJAN
2017	6089	28597.9
2016	6266.7	29367.1
2015	6871.4	28977
2014	7222.8	29617
2013	7140.1	29456
2012	6924.6	26908.8
2011	7084.2	25752.9
2010	7178.9	26349.6
2009	6903	23681.6
2008	7752.6	23405.4

Source: SOCAR. (2018).

SOCAR's investments abroad is linked with both oil and natural gas. SOCAR plays a crucial role in Azerbaijan's foreign policy. In other words, it reflects the country's independent energy policy. It is worth to note that energy question is not merely subject of economic interests, it is strongly wrapped in power politics; that is clear when we look at the major oil companies and how they have been interconnected with the states (Helm, 2006). The following section shed light into why and how oil companies invest abroad and what policies do oil rich countries pursue vis-à-vis their oil companies.

#### 4. SOCAR's investments abroad

SOCAR has invested in a few countries which include Georgia, Turkey, Ukraine, Romania and Switzerland. By the third quarter of 2018, SOCAR's total investments abroad was around \$14 billion, of which \$12.6 billion accounted for projects in Turkey<sup>2</sup> (Daily Sabah, 28 March 2018; Israfilbayova, 2017). Nearly \$415 million has been invested in various projects in Switzerland. Georgia has received investments worth \$386 million whereas Ukraine \$281 million. Romania is the last in the list with \$71 million. SOCAR runs over 370 petrol stations in these countries (Israfilbayova, 2017). As Turkey takes the lion's share in SOCAR's foreign investments, the following section looks at what these investments are.

<sup>2</sup>SOCAR plans to invest \$7 billions more in Turkey by 2020, so its total investment will hit almost \$20 billion once the planned projects are completed.

## 5. SOCAR in Turkey: economic and strategic interests

As already have been touched upon, SOCAR's main investments are in Turkey. It is important to have a glance at the history of SOCAR's investments in this country and then discuss what prospects it has brought about in the long run.

SOCAR started its investments in Turkey in 2008 by purchasing 51% stake in Petkim, a leading petrochemical company in Turkey, for \$2.04 billion (Oxford Business Group, 2009, p.113). With already completed as well as ongoing projects, which would be worth around \$20 billion by 2020, SOCAR is Turkey's largest international investor in regard to energy projects. SOCAR plans to construct a new petrochemical complex in Turkey by 2022 (Daily Sabah, 28 March 2018). SOCAR Turkey Enerji, an affiliate of SOCAR, is responsible for the company's operations and investments in this country. SOCAR's investments in Turkey are represented by: Petkim, SOCAR Turkey Aegean Refinery (STAR), Petlim Container Terminal, Pektim Wind Power Plant and TANAP (Baily, 22 October 2018; Aliyeva, 2017).

STAR stands out among the above investment projects with \$6.3 billion in cost, for which construction was started in 2011. On October 19, 2018 Azerbaijani President Ilham Aliyev and Turkish President Recep Tayyip Erdogan attended the inauguration ceremony of the project in Izmir. With its 10 million tons of annual oil processing capacity STAR is expected to meet the demands of the local market and reduce Turkey's dependence on imports of certain products such as naphtha (Baily, 22 October 2018). SOCAR and Ministry of Economy of the Republic of Azerbaijan are the shareholders of STAR with 60% and 40% respectively. SOCAR invested \$55 million for the Petkim Wind Power Plant, which has the 51 MWT capacity, to supply electricity for its premises in Aliaga/Izmir (Baily, 22 October 2018). SOCAR has further investment plans in Turkey, namely it plans to construct a new petrochemical complex in Turkey by 2022 (Daily Sabah, 28 March 2018).

Above all, SOCAR's investments in Turkey are favored by cordial relations between Azerbaijan and Turkey. Both countries have supported each other in international politics. Turkey is the major ally of Azerbaijan in the region. Apart from political and economic interests, it has also cultural and linguistic ties with Azerbaijan (Bertsch et al., 2000, p.17).

Economically SOCAR's investments will decrease Turkey's dependence from foreign sources for petrochemical products. It should be noted that Turkey is one of the major consumers of the oil and oil products in Europe and Middle East. Once performing in full capacity, STAR is expected to meet nearly 25%

of Turkey's demands for oil products, including aircraft fuel and naphtha. This in return will also partially alleviate Turkey's foreign trade deficit, which is substantially incurred by the country's energy imports (Report News Agency, 19 October 2018).

For SOCAR, namely for Azerbaijan, it will increase the company's market share in the petrochemical industry in the region. It has significant strategic value, because with realization of projects such as STAR, SOCAR is going to participate in the real economic circle in Turkey rather than just exporting its oil. That is to say, SOCAR will not necessarily continue processing its own oil in Turkey, it can process imported oil from other sources, e.g., Russia, as well, which in return will bring long-term revenues for the company. Moreover, SOCAR diversifies its business portfolio with such investments.

In 2017, SOCAR's revenues in Turkey increased nearly by 42%, becoming 4.9 billion AZN (equivalent to \$2.8 billion) from 3.5 billion AZN in 2016 (Caspian Energy News, 14 June 2018). This number is more likely be multiplied given the launch of above-mentioned projects in 2018. STAR alone is expected to bring nearly \$850 million revenues in the next five years (Report News Agency, 19 October 2018). Azerbaijan's oil production peaked in 2010, and since ever it has been decreasing (see Table 1). To the backdrop of decreasing oil production, diversification of revenue flows is very important for Azerbaijan. And, SOCAR's investments serve for this purpose; namely, investments abroad can offset the decreasing revenues of oil production in Azerbaijan.

## Conclusion

Oil companies act as important instruments for a states' energy policy. They can serve both the strategic and economic interests of their countries by investing abroad. SOCAR's investments in Turkey are a clear example for this. For a small state like Azerbaijan, SOCAR has accomplished important goals by investing in European and Middle Eastern energy markets. Doing so, the company has transformed itself as well; SOCAR is not merely a crude oil producer anymore, thanks to its investments in petrochemical industry in Turkey. Azerbaijan is going to harvest the benefits of SOCAR's investments for many years to come. Moreover, gaining important experience in the production of oil products, SOCAR will continue its expansion into foreign markets.

In Turkey, SOCAR can supply various oil products such as naphtha, aircraft fuel and liquified petroleum for domestic use in Turkey. That has relieved Turkey from the import burden of these products and positively contributed to the country's foreign trade balance. For the last 15 years, the

Turkish-Azerbaijani relationship has been strengthened by implementation of various energy and infrastructure projects such as the Baku-Tbilisi-Ceyhan oil pipeline, the Baku-Tbilisi-Erzurum gas pipeline and the Baku-Tbilisi-Kars railway. SOCAR's investments in Turkey have made great contributions in this respect as well.

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