

American University of Armenia

The Role of Oil in the Formation of Azerbaijan's Foreign Policy

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Contents

List of abbreviations	5
Abstract.....	6
Introduction	7
Relevance of the Topic	9
Brief History of Azerbaijan: First Years of Independence	10
Contract of the Century.....	11
Ilham Aliyev Becomes the President: ‘Caviar Diplomacy’	12
Literature Review: Foreign Policy Formation.....	15
Foreign Policies of Oil-Rich States	17
Methodology.....	18
Brinkmanship	20
The Construction of Baku-Tbilisi-Ceyhan Pipeline	22
Content Analysis	29
Interview Analysis.....	35
Aliyev's Regime Survival	36
Oil in Azerbaijan’s Foreign Policy Formation	37
Changes in Azerbaijan’s Foreign Policy after BTC construction.....	37
Cheap Oil’s Effect on Azerbaijan’s Foreign Policy	38
Possible Developments in Nagorno-Karabakh Conflict.....	38
Conclusion.....	40
Bibliography.....	42
Appendices	46

Table of Figures

Figure 1: Azerbaijani Oil Rents (% of GDP).....	8
Figure 2: The BTC Co. shareholders.....	22
Figure 3: Contractor Parties and Participating Interests: ACG Oil Field.....	23
Figure 4: Oil Production (1000 bb/day).....	23
Figure 5: Oil Prices in USD.....	24
Figure 6: SOFAZ Transfers to State Budget (million USD).....	25
Figure 7: SOFAZ Transfers % of State Budget.....	25
Figure 8: Military Expenditure (million USD).....	26
Figure 9: Regression: Military Expenditure & SOFAZ Transfers.....	27
Figure 10: Correlation: Military Expenditure (million USD) & SOFAZ Transfers (million USD)...	27
Figure 11: Number of Speeches analyzed.....	30
Figure 12: Content Analysis: Categorization of Codes.....	30
Figure 13: Content Analysis: Description of the Intensity Levels of Codes.....	31
Figure 14: Code 'Territorial Integrity': Frequency and Intensity level.....	32
Figure 15: Category 'Armenia as an 'Aggressor'': Frequency and Intensity level.....	33
Figure 16: Category 'War Statements': Frequency and Intensity level.....	34
Figure 17: Category 'Energy': Frequency and Intensity Level.....	35

List of Abbreviations

ACG-Azeri–Chirag–Gunashli complex of oil fields

AIOC-Azerbaijan International Operating Company

BP-British Petroleum

BTC-Baku-Tbilisi-Ceyhan pipeline

GDP-Gross Domestic Product

MFA-Ministry of Foreign Affairs

NK-Nagorno-Karabakh

NKR-Nagorno-Karabakh Republic

SOCAR-State Oil Company of Azerbaijan Republic

SOFAZ-State Oil Fund of Azerbaijan

U.S.-United States

USD-United States Dollar

USSR-Union of Soviet Socialist Republics

Abstract

Oil is one of the significant commodities which revenues are higher than revenues of any other natural resource including gas. The present paper discusses the role of oil in the formation of Azerbaijan's foreign policy towards Nagorno-Karabakh conflict. The research is restricted to the period between 2003, when Ilhan Aliyev came to power, and 2015. This period is also significant due to the construction of BTC in 2006, which enabled Azerbaijan to increase its oil exports significantly. The paper discusses whether Azerbaijan's foreign policy became more aggressive with changes in oil revenues. The research uses a mixed-method. First, the relationship between oil revenues and military expenditure is established; which turned to be positive. Second, speeches and statements of Azerbaijani officials were analyzed that showed that drastic changes in oil revenues resulted in more aggressive rhetoric from the Azerbaijani officials. Finally, interviews conducted with experts and diplomats demonstrated that Azerbaijan uses oil revenues to improve its image abroad and enhance anti-Armenian policy. Lastly, it is shown that oil revenues enable Azerbaijan to utilize vastly '*brinkmanship*' in NK issue and receive nearly no criticism for its foreign policy from the international community.

Key words: Azerbaijan, Nagorno-Karabakh, oil, brinkmanship.

Introduction

Despite being an essential commodity on a global scale, oil is often regarded as one of the principal causes of wars (1) between rival groups for the possession of the fields, as well as (2) by the oil-rich states for the national interests they pursue – either legitimately or not. This paper embraces the second issue and will concentrate on the case of Azerbaijan.

Among numerous international conflicts that occurred because of natural resources, carefully indicated by the students of war and peace studies and international think tanks (such as SIPRI, Uppsala or IISS), the study has chosen the case of the Republic of Azerbaijan in order to demonstrate the effects of oil in the formation of the foreign policy of this relatively newly independent

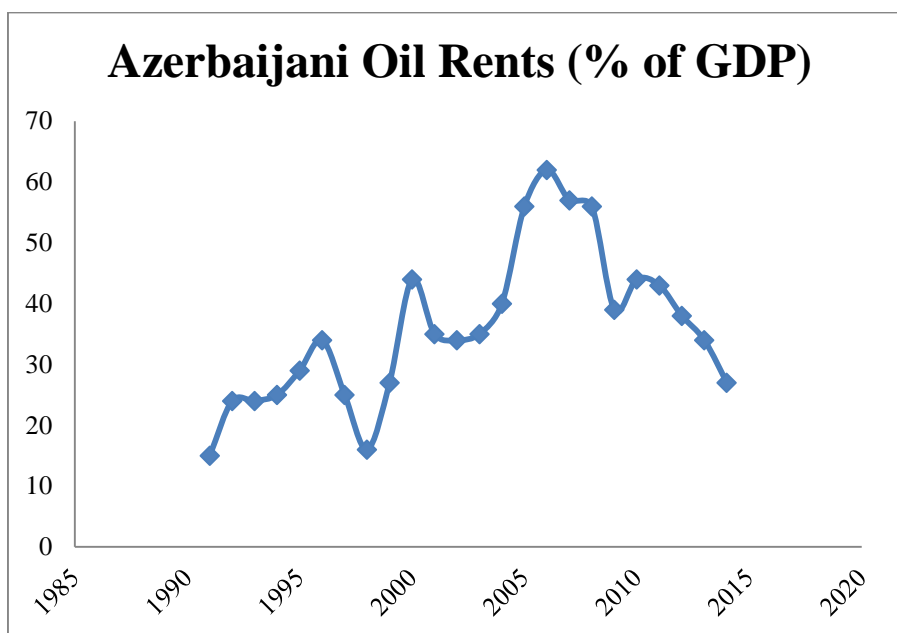
“The total value of its (oil) trade is many multiples larger than the trade of any other natural resource, including gas, diamonds, timber, or coffee” (Colgan 2013).

country that is famous for having ‘*firmly entrenched*’ authoritarian rule (Diwan and Galal 2016) and who also sits on vast proven reserves of hydrocarbons in the Caspian Sea (“Do Not Fund Southern Gas Corridor with EU Money” 2016). Azerbaijan also owns gas resources; however, revenues coming from oil are much higher; that is why oil is likelier to have a bigger effect on country’s foreign policy formation (“Oil Revenue by Country, around the World” 2016). What is more, unlike the gas market, which is mainly based on yearly contracts, oil market lets the countries be more flexible in terms of their exports (without long-term agreements); thus enabling them more unrestricted choice of partners for exports.

According to the World Bank data starting from the independence, Azerbaijan’s oil rents were always much higher than 10% of the GDP. Thus, it is evident how essential is this resource for Azerbaijan. The graph below shows the numbers starting from 1991 to 2014 (“Oil Rents (% of

GDP) Data Table” 2016; *Reuters* 2015). Colgan (2013) and Ross (2012) call this type of country a ‘*petro-state*,’ when big part of country’s economy comes from oil revenues, and also, oil plays a crucial role in country’s foreign policy making.

Figure 1: Azerbaijani Oil Rents (% of GDP)



The present paper aims at exploring the role of oil in the formation of Azerbaijan’s foreign policy, explaining various events and general developments of foreign policy of this country since 2003, which is the year when Ilham Aliyev came to power making Azerbaijan’s foreign policy toward NK issue more aggressive (Interview with NKR Diplomat 2 March 23rd, 2016).

Furthermore, in 2006, the **construction of BTC** oil pipeline was finalized, which was an export route bypassing Russia and oriented to the Western market through the Mediterranean. This was an important step for Azerbaijan, as having access to European market made it more independent in its foreign policy formation (Interview with Expert 2 on Regional Studies April 19th, 2016).

Indeed, a certain amount of oil from the Azerbaijani oil fields in the Caspian Sea have been filling

newly independent Azerbaijan's state budget since the 1990s.¹ However, beginning from 2006 (after BTC construction) the exports and revenues of Azerbaijani oil *increased drastically*. Hence, the aim of the current paper is to shed extra light on whether the increase in oil revenues is responsible for any changes in the country's foreign policy.

While investigating the foreign policy of Azerbaijan, we will put the emphasis on the country's position on the NK issue as it is one of the top priorities in its foreign and security policies that have been affirmed as such in almost every public appearance of President Aliyev. In other words, this paper looks at the factor of oil in the foreign policy of Azerbaijan through the lenses of Nagorno-Karabakh conflict; since we believe (and Azerbaijani leadership confirms this publicly) it's at the heart of this country's foreign and domestic policies. The paper suggests that the concept of '*brinkmanship*' best explains the motives and rationale of oil regimes, and Azerbaijan is no exception, sometimes dance on the tight rope being sure that the importance of their oil deliveries to international markets outweighs misbehavior and disobedience to rules of international life.

Relevance of the Topic

The topic is relevant to the field of International Relations as Azerbaijan's foreign policy is not the usual choice of researchers and policy analysts in analyzing the foreign policy behavior of authoritarian regimes in oil-rich states. Furthermore, many studies have examined the impact of oil on this country's domestic policy (Guliyev 2009; Franke, Gawrich, and Alakbarov 2009; Filetti 2012); however, its influence on foreign policy and the likelihood of aggressive foreign policies of these states is not analyzed most often. Besides, as Armenia is neighboring Azerbaijan and has been engaged in the Nagorno-Karabakh conflict since an early date ("CHIRAGOV AND

¹ Note: Before the construction of BTC two pipelines were operating from Azerbaijan: Baku-Supsa that carried oil to Georgia; and Baku-Novorossiysk pipeline that connected Azerbaijani oil to Russia.

OTHERS v. ARMENIA” 2016) as an important party/stakeholder affected in the dispute (“Resolutions Adopted by the United Nations Security Council in 1993” 2016), better understanding of foreign policies of Azerbaijan (a challenging endeavor itself) becomes also highly relevant and timely.

Brief History of Azerbaijan: First Years of Independence

After the collapse of the Soviet Union Azerbaijan needed to recover its economic situation as at that time it was in severe crisis. At the final years of the USSR, Azerbaijan ranked 10th among 15 Soviet Union republics in terms of economic welfare. Besides economic conditions, Azerbaijan was also facing a political crisis during the first years of independence and before it. Since 1987-88, it was facing ethnic conflict with NK (Mousavi 2010). While being in the pick of the conflict, Azerbaijan gained its independence in fall 1991. Nonetheless, in comparison with other post-Soviet states, it also had to tackle the problem of growing ethnic nationalism and indeed chauvinism to keep the country together and not to allow it to collapse in its own right.

To recover the economic situation, in 1992 SOCAR was created in Azerbaijan that was for managing oil sector. The new fund (SOFAZ) was initiated to have a separate budget for oil resources. The main aim of SOFAZ is to administer the oil revenues and invest them in another sector of the economy with the aim to develop non-oil sector. In the official web-site of SOFAZ, all reports about oil revenues can be found starting from 2001, which is publically available (“ARDNF - Azərbaycan Respublikası Dövlət Neft Fondu - Home” 2016). Nevertheless, both SOCAR and SOFAZ are under the president’s control. Hence, it can be argued that creating SOFAZ was additional step by Azerbaijani president to centralize corruption.

In addition to economic issues and being in the war, the country was in an **unstable** domestic political situation. During the first two years of independence three presidents have lost

their posts because of the volatile situation in the country and losses in war (Kamrava 2001). In 1993 after the insurgency against Elchibey's government Heydar Aliyev came to power, who remained in post until 2003 (De Waal 2003). After taking the office, Aliyev needed to manage oil resources. Thus, he needed to end the war so that he could cooperate with oil companies abroad. On 12-13th May, midnight, 1994, a trilateral ceasefire agreement was signed between NK Armenia, and Azerbaijan ("Cease-Fire Agreement - MFA NKR" 2016) that enabled Azerbaijan to stabilize its domestic situation and enlarge its energy cooperation.

Contract of the Century

During the first years of independence, oil was the primary determinant of Azerbaijan's economy as well as foreign policy formation. However, it is widely accepted that it causes authoritarian regime rather than democratic (Azerbaijan is not an exception) (Ross 1999; Franke, Gawrich, and Alakbarov 2009). Being located between two big regional powers, and having vast oil resources, cooperation with multinational oil companies was the only method to preserve Azerbaijan's economy and national security (Ipek 2009).

Perhaps since the first days of independence international oil companies, with BP in the forefront, expressed interest to develop oilfields in the Azerbaijani sector of the Caspian as Azerbaijan resources provided an alternative for the European market and less dependence on Russia and OPEC (Expert 2 on Energy Politics April 25, 2016). The bright example of international interest was **Margaret Thatcher's' visit to Baku** two years before the Contract of the Century. It was the most notable event in Azerbaijan's history since its independence ("Thatcher in Baku: How BP Broke into Azerbaijan" 2016).

Contract of the Century was signed on 20th September 1994 (Ipek 2009). SOCAR engaged in Production Sharing Agreement with eleven international oil companies, among them BP and

Lukoil. The Contract included the exploitation of Azeri, Chirag and Gunashli fields. The duration of the agreement was agreed to be 30 years. After the contract, AIOC was created to manage the agreement on behalf of the companies in the contract. In June 1999, BP Amoco 'assumed operatorship for AIOC' ("AIOC Celebrates 5 Year Anniversary" 2016).

Contract of the Century was the most successful agreement for the newly independent and volatile Azerbaijan. After, big amount of investments flow to the country, that enabled Heydar Aliyev to consolidate its power until 2003, beside corrupted and not legitimate government. Further, Aliyev strived to anchor his legitimacy in foreign relations. Being a pragmatic and experienced leader he could reach Azerbaijan's strategic partnership with the U.S. by the end of the 1990s: after 9/11, Azerbaijan was the only country in the region that supported America in Afghanistan War. Azerbaijan also managed to become NATO's Partnership for Peace member in 1994 (Cornell 2011).

On December 15, 2003, Heydar Aliyev passed away, and his son succeeded him. Reserving the post till present day, Ilham's foreign policy is significantly different from that of his father, as starting from the first years of his presidency, Azerbaijan became more aggressive in its foreign policy (Interview with Expert 3 on Regional Studies March 23rd, 2016).

Ilham Aliyev Becomes the President: 'Caviar Diplomacy'

After coming to power, Aliyev faced economic problems. This was the time of oil boom, thus, he had to decide how to distribute oil wealth. On the one hand, oil increased country's GDP, however; on the other hand, it created more inequality as there were no enough job opportunities (Kendall-Taylor 2012; Iunusov 2003). Nonetheless, Ilham Aliyev preserved its power for more than ten years.

According to Langerek (2014), there are several reasons for the **regime stability** in Azerbaijan. All of them are dependent on the energy reserves that the country possesses. One of the main reasons for regime constancy in Azerbaijan is the rise in public spending. Taking that oil prices raised dramatically in 2008, Azerbaijani economy boosted from the oil revenues. Thus, it could afford to spend more on public goods. The poverty rate in Azerbaijan also has decreased; if the rate was 49 % in 2000, in 2012 it reached just six percent. One-third of the Azerbaijan society works in the public sector. This factor also makes the citizens for the incumbent's domestic politics ("Reporters Without Borders" 2009).

The other reason pointed by Langerak (2014) is the weakness of the civil society as it not able to make any crucial change (Sultanova 2014) . Moreover, due to an authoritarian regime, many public workers are afraid of being critical, as they risk losing their jobs. Patronage is the other reason for the regime stability (Langerak 2014), as the majority of the high posts are occupied by the Aliev's clan or their affiliates. Thus, there is no strong opposition in the country as majority of them either jailed or expelled, which could make a change in the political system, as political activists or journalists are either jailed or expelled from the country. However, oil partner democratic states such as US and EU countries do little to stop a deteriorating human rights situation (Kramer 2015).

Furthermore, the lasting Aliev's regime comes from the "**apathy**" coming from the **international community** (Langerak 2014). The US and Europe do not strive for any change in the country as it will bring instability inside Azerbaijan. Taking into consideration that Azerbaijan is essential for the West with its resources and geographic position, the EU does not want to have instability in the country. Moreover, Azerbaijan is important for the West due to energy security and also dependence on Russia, which means that Azerbaijan is an energy alternative for the Europe.

During the presidency of Ilham Aliyev, Azerbaijan has been one of the most **authoritarian** regimes and many journalists in the country were harassed or jailed due to their political preferences. Moreover international radio stations like Radio Liberty, BBC, and Voice of America on Azerbaijani airwaves were forbidden (“Reporters Without Borders” 2009). Regarding freedom of media, Azerbaijan is not in a good situation. However, Azerbaijan is still a member of one of the most democratic organizations: CoE. Many have been blaming this organization for its so-called ‘caviar diplomacy’ with Azerbaijan (Thomsen 2016). The main argument is that Europe closes eye on Azerbaijan’s

In 2013 Azerbaijan spent 2.3 million USD to have an influence on the U.S. foreign policy and became the tenth state on the list for this spending (“Influence Explorer” 2016).

misbehavior that is violation of human rights, freedom of speech etc. The term ‘caviar diplomacy’ first was used as report title of a European Stability Initiative (ESI) in its May 2012 report (Coalson 2013). It was addressing Europe’s apathy towards human rights violations in Azerbaijan

“Azerbaijan was the second-leading jailer of journalists in Europe and Central Asia. Only Uzbekistan jailed more” (“Attacks on the Press: Azerbaijan” 2007).

and its authoritarian regime. Particularly Council of Europe is blamed for not sanctioning Azerbaijan despite its authoritarian regime, human rights violations, fraud in elections, etc. (Caucaso 2016). This diplomacy is possible for Azerbaijan due to its vast oil revenues, that allow the country to have strong lobbying in Europe as well as in the US (“10 Members of Congress Took Trip Secretly Funded by Foreign Government” 2016).

Literature Review: Foreign Policy Formation

Saunders (2011) argues that leadership is essential in the formation of states' behavior. Thus, the nature of the regime and the character of leadership are crucial to the foreign policy behavior of the state. Smith et al. (2005) claim that the main incentive for leadership's action is to sustain the power. Thus, if a leader has other goals rather than remaining in power, they are unlikely to stay long in power. However, leaders may have other incentives: such as territorial, personal, etc. Furthermore, some scholars (De Mesquita 2005; Narang and Nelson 2009) argue that revolutionary leaders are more likely to take risks, as without taking a risk, it is unlikely that they would succeed. Furthermore, revolutionary leaders are less likely to have domestic constraints on their behavior; hence, they are more liable to involve in international wars (Huntington 1968; McNeill 1980; Walt 1996). Thus, a vast amount of literature suggests that revolutionary regimes are more aggressive in the international arena (McNeill 1980; Gurr 1988; Maoz 1996; Walt 1996; Enterline 1998; Snyder 1999).

Some authors (Appenrodt 2008; Bader, Grävingsholt, and Kästner 2010) point that foreign policy is mainly a continuation of domestic policy. Moreover, Morgan and Bickers (1992) argue that a leader can start a war or initiate aggressive foreign policy to remain legitimate. Ilham Aliyev's example clearly illustrates this point, as he keeps external enemy image of Armenia to discredit the later ("Address of Foreign Minister of Armenia Edward Nalbandian at the Stockholm International Peace Research Institute (SIPRI) - Press Releases - Ministry of Foreign Affairs of the Republic of Armenia" 2016). What is more, Aliyev needs to justify domestically its aggressive actions that are illustrated in his official speeches ("Official Web-Site of President of Azerbaijan Republic 2016), when he accuses Armenia to be an 'aggressor'.

Hence, to understand foreign policy of the country, we should have a look at its internal

politics. However, to find out the impact of the oil on the state's foreign policy, first of all, we should look at the '**resource curse**' in domestic policy. Oil-rich states are mostly authoritarian and not accountable. Although, this characteristic of internal politics can be observed in non-oil regimes as well however, the vast amount of cash revenues from oil make it easier for the leader to purchase the power from its citizens (Karl 1997; Herb 1999; Hertog 2010).

Le Billion (2005) develops the argument pointing that oil is a reason for internal conflicts as well. However, Colgan (2013) indicates that the existence of oil alone is not enough ground for wars. He mentions that in case if a state has a vast amount of oil reserves, it will have fewer incentives to go into war, as opportunity cost will be much higher for that state. Thus, he claims that the international wars are mostly caused by revolutionary oil rich regimes. He defines revolutionary regimes as the regime which leadership has been changed after revolutions, coups, etc.

In addition, many authors assert that the existence of oil is an obstacle to democracy (M. L. Ross 2001; Jensen and Wantchekon 2004; Goldberg, Wibbels, and Mvukiyehe 2008; Bearce and Hutnick 2011; Andersen and Aslaksen 2013). Some assert that oil regimes can avoid accountability due to 'rentier politics,' which suggests that from the oil revenues the leadership decreases taxes and also provides better public goods (Mahdavy 1970; M. L. Ross 2001; Bellin 2004; Ulfelder 2007; Guliyev 2009). Nevertheless, this does not mean that there is no opposition in oil-rich countries. As the one of the primary goals of the leaders is to maintain the power, the leaders of these states ensure their constituency, and therefore, the opposition is less likely to win (Smith 2004).

Foreign Policies of Oil-Rich States

Oil can affect the state's foreign policy in two ways: it can either push for aggressive foreign policy, as petro-states are not accountable to their citizens, or lead to the peaceful foreign policy as these states need foreign partners to ensure oil trade with them (Colgan 2013). To support the first argument, the author brings an example of Saddam Hussein who remained in power after the eight-year (1980-88) war with Iran and unsuccessful military adventure with Kuwait in 1990. However, he was not removed from office by domestic opposition (as it is unlikely that there was an opposition, as in many other oil-rich states) after that kind of aggressive foreign policy. The other example was the case of Gaddafi, who, in spite of the aggressive foreign policy, like Lockerbie bombing in 1998 (Dobrovetsky 2004) or military conflict with Chad from 1982-1990 (Meerpohl 2013) remained in power for four decades. Furthermore, according to several authors (Fearon and Laitin 2003; Collier and Hoeffler 2004; Hegre and Sambanis 2006; Le Billion 2007). Natural resources, and among them access to hydrocarbons; oil and gas, were among reasons of modern international conflicts to occur. They claim that oil is likely to cause war among states, as in this case the prize for winning the war (oil) is higher. This argument supports the evidence of civil wars in Angola, Indonesia, Sudan, Nigeria, etc.

As mentioned above, oil can be also a tool for peaceful foreign policy. The example is the relations between the U.S. and Venezuela where in spite of the offensive stance of Hugo Chavez towards the States, Venezuela continued exporting oil to the U.S. Another reason that oil-rich states would likely strive for peaceful foreign policy is their dependence on investments and the preference of oil consuming countries, as these countries may change the type of consuming energy by turning to nuclear energy, coal, etc. (Colgan 2013).

Various scholars (Chan 1980; M. L. Ross 2001) also assert that oil-rich states spend much on the military posits that these spending are even higher during the times when oil is expensive. Thus, it can be argued that oil factor broadly affects international security.

Methodology

The research puzzle that this paper aims to tackle is the following:

RQ: What is the role of oil in the formation of Azerbaijan’s foreign policy?

The research design for the paper will be explanatory as it tries to explain the causal relations between the two variables. The independent variable is ‘the role of oil’ and dependent one is the ‘formation of Azerbaijan’s foreign policy’.

To answer the question the paper hypothesizes the following:

Hypothesis₁: The factor of oil makes Azerbaijan’s Foreign Policy more aggressive.

Hypothesis₀: The factor of oil does not make Azerbaijan’s Foreign Policy more aggressive.

To test the hypothesis, the study uses mixed method. For the qualitative part, Interviews with three experts on regional studies, two experts on energy politics and two NKR diplomats in European countries are conducted. The sample for interview is chosen in a way so that to have diversity of interviewees. The other factor that will be analyzed to show the patterns in the rhetoric (both domestic and on the international scene) of the President of Azerbaijan Ilham Aliyev and also the speeches of Azerbaijani minister of foreign affairs, as a supportive material available in

the website of Azerbaijani MFA. The period is chosen from 2004 to 2015 due to the availability of the speeches. The total number of speeches and statements analyzed is 126.

For the quantitative part, secondary data is used in order to see whether there is a correlation between **military expenditure** of Azerbaijan and oil revenues. The study of both military expenditure, as well as foreign policy rhetoric (content analysis) will help to elaborate on the degree of **aggressiveness** of Azerbaijan – as a relatively new player in the international oil market, which also has to deal with a “frozen” conflict regarding Nagorno-Karabakh. Furthermore, the concept of brinkmanship will be utilized to frame the conceptual basis of the study and understand the aggressiveness foreign policy of the country.

Limitations of the Study:

One of the major limitations is time dedicated to the thesis. Secondly, the study uses only the speeches and statements available at MFA official website and due to language issue content analysis was only possible to do (as videos of speeches were mainly in Azerbaijani language). Therefore, discourse analysis was not done. However, we believe that discourse analysis would be more appropriate to analyze the speeches.

Brinkmanship

“**Brinkmanship** is the art or practice of pursuing a dangerous policy to the limits of safety before stopping” (Knowles 2006, 89). The term is commonly used in politics to explain foreign policy patterns. The origin of the concept stems from the interview in 1956 (during the Cold War) with the American politician and lawyer John Foster Duller, who with an elegant wording pointed that Americans were able “**to get to the verge** (during the Cold War) without getting into the war’ (Dobson 2009).

To put it in a simple way, Brinkmanship means that one party stands on the curved slope and any step can be dangerous for both sides. This is because the chance of slipping from the curve is too high and it becomes even higher with each move (escalation). It is the situation when one can fall despite the best efforts not to do so and will take the adversary with him (Schelling 1980).

Thus, brinkmanship is a deliberate action carried by one side that follows an apparent risk of escalation. The other part realizes that if it makes a step the war will be inevitable. Thus, the part that creates this situation harasses the adversary that the latter should not make any action otherwise war is inevitable. Hence, in this situation, war cannot be controlled even by the first side that creates the situation (Schelling 1980).

While speaking of brinkmanship the first example that comes to mind is nuclear threat between Soviet Union and the United States. To the realists this was a victory for their beloved Realist theory. The arms race between United States and Soviet Union may have an impact on dissolution of the Soviet Union. (“The Cuban Missile Crisis: The Importance of Power and Knowledge” 2016). However, for both of them the red line was to start the nuclear war, as it would trigger mutually assured destruction (MAD) for which none was ready for or willing to.

The cases of Brinkmanship can be widely observed in oil rich countries' foreign policies. The rhetoric of Chavez against the United States was another example (Bottome 2011) . However, although Chavez was tough in his speeches against the U.S., he needed the U.S., as it is one of the big consumers of Venezuela's oil ("U.S. Imports from Venezuela of Crude Oil and Petroleum Products (Thousand Barrels)" 2016) .

Iraq is another oil rich country that engaged in Brinkmanship in its foreign policy (Pipes 2016) . The Iraqi invasion to Kuwait was an unsuccessful attempt of brinkmanship, as at that time Saddam went to war without having thoroughly calculated the consequences of military aggression against the neighbor, and as brinkmanship suggests the events cannot be controlled thoroughly the moment you trigger the escalation even by the part that initiated it. Thus, Iraqi invasion was failure as the US engaged in actions ("Saddam Refuses to Withdraw from Kuwait: August 1990 to January 1991" 2016).

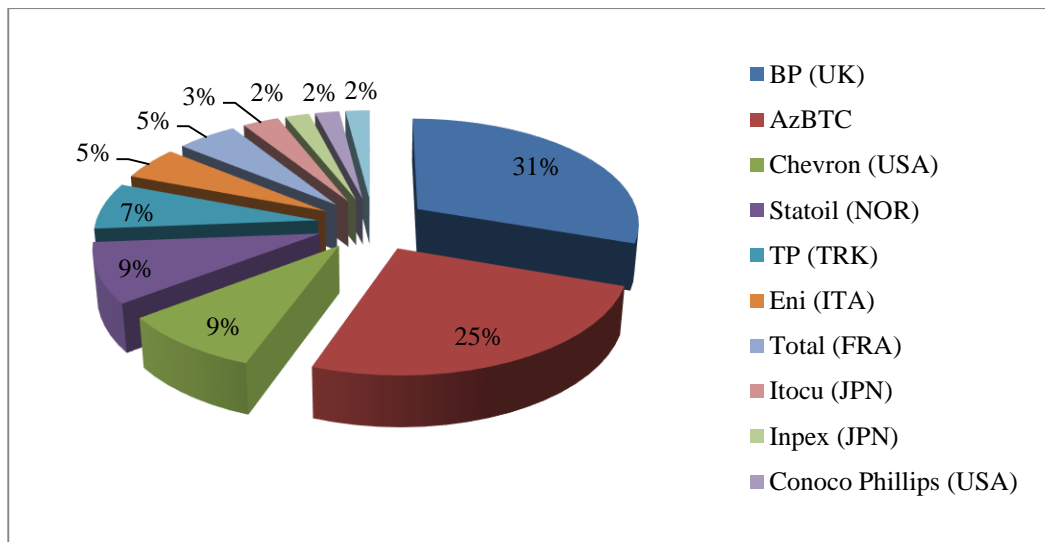
The literature on oil regimes suggests that **oil-rich countries are likelier to engage in Brinkmanship**. First of all, as one of the experts suggests oil revenues allow exporting states to increase their military expenditure and they do so deliberately to project military power beyond their borders and engage in arms race with their adversaries (Expert on Energy Politics 1 2016) . Hence, they are becoming more assertive in their foreign policy. Secondly, oil rich countries are more likely to be indisputable in international arena as they have at least one feature that makes them an essential player in international sphere: oil.

The Construction of Baku-Tbilisi-Ceyhan Pipeline

First years of presidency was quite successful for Aliyev as after three years BTC started to operate in 2006. The construction of the pipeline was one of the most important events for Azerbaijani history. It increased Azerbaijan's oil exports and enabled the country to deliver oil to the European market.

The graph below illustrates current shareholders of BTC ("Baku-Tbilisi-Ceyhan Pipeline Pipelines Operations and Projects BP Caspian" 2016). As it is obvious the big part of the shares belongs to BP and it is also manages the consortium. The second biggest company is Azerbaijan BTC Oil Company. The other shareholders are mainly European countries, U.S., Turkey and Japan.

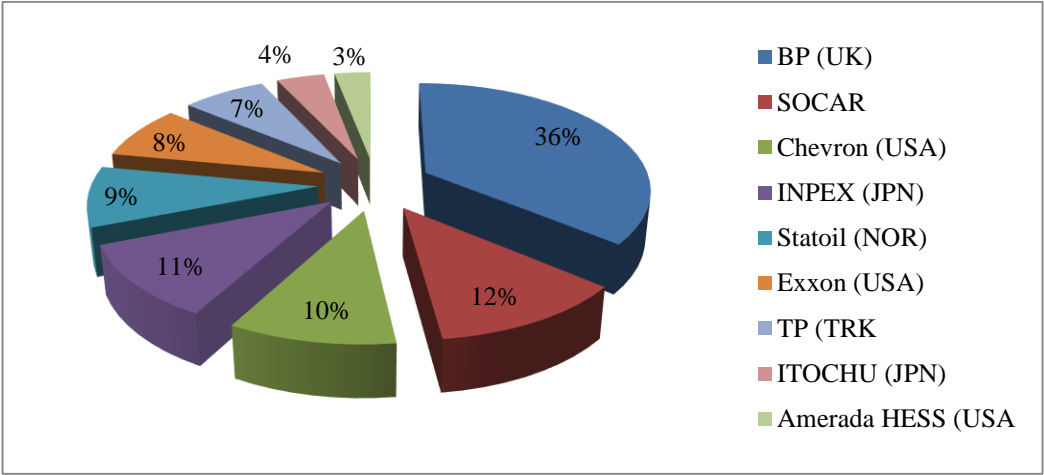
Figure 2: The BTC Co. shareholders



Further, the next graph illustrates parties in ACG oil field, which is the major oil field in Azerbaijan, and BTC carries oil to Turkey from this field (<http://www.socar.az/>). As it is shown in the graph only 12% of the shares belong to SOCAR, which is not a big amount taking into

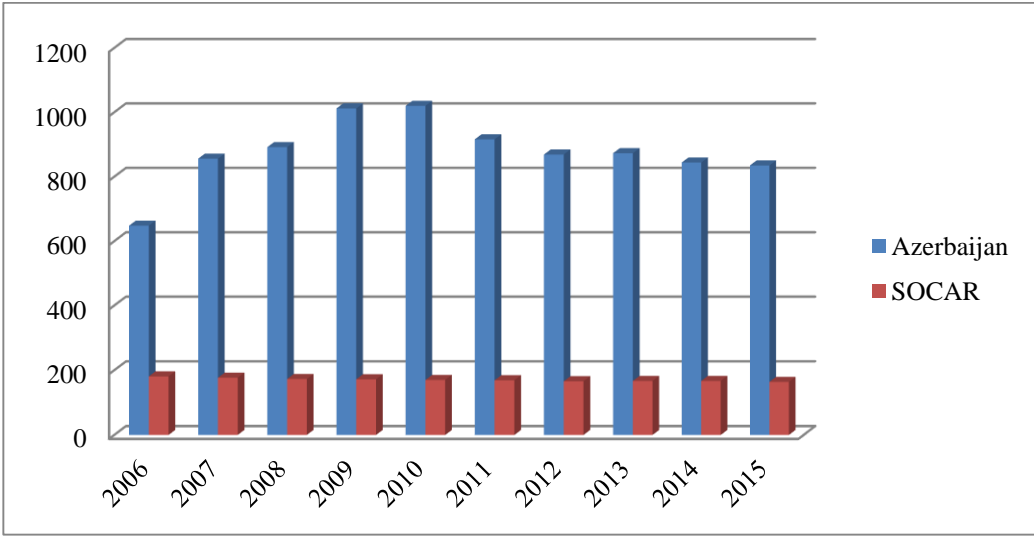
consideration current low price for oil. In this case also the biggest part of shares belongs to BP (35%).

Figure 3: Contractor Parties and Participating Interests: ACG Oil Field



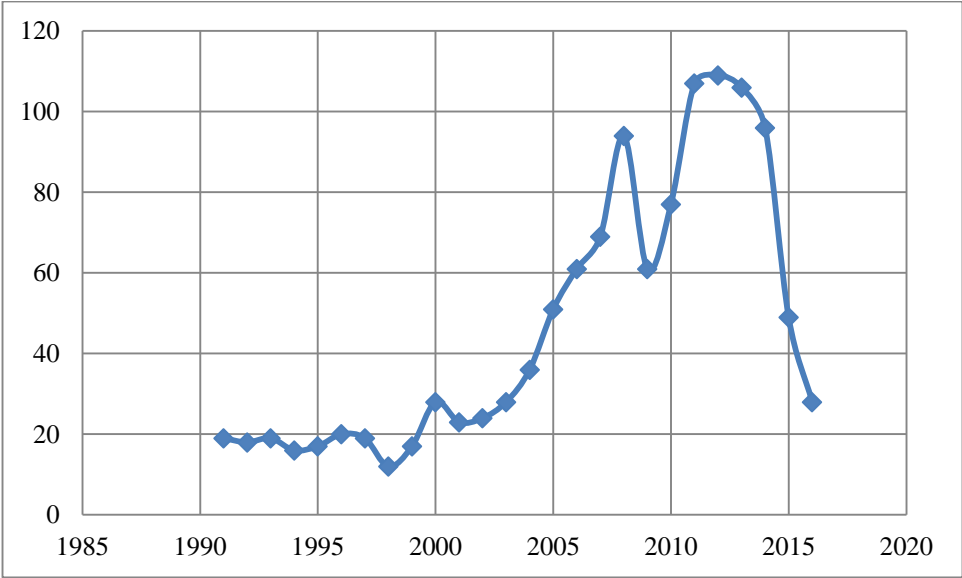
The other graph below shows Azerbaijani oil production. It shows both the total oil production of the country and share of SOCAR. It can be noticed that oil production started to decrease from 2011 (SOCAR.az). Furthermore, according to experts' estimates the production of Azerbaijani oil is going to decrease further (Waal 2016).

Figure 4: Oil Production (1000 bb/day)



The next graph illustrates oil prices from 1991-2016. It can be noticed that price drastically raised from the year of 2010, however starting from 2013, the price started to decrease dramatically (“OPEC Crude Oil Price Annually 1960-2016 Statistic” 2016).

Figure 5: Oil Prices in USD



Thus taking into consideration the fact that Azerbaijan spends at least 16\$ (“What Oil Price Considered ‘red Line’ for Azerbaijan?” 2016) to export oil through BTC it is unlikely that during this low prices it will have profits or the profits will be too low because SOCAR’s share in ACG is just 12% as showed in one of the previous graphs.

Naturally with the high oil production revenues from oil also rose. As officially SOFAZ manages the revenues coming from oil, below are illustrated SOFAZ’s transfers to state budget. It can be noticed that transfers have increased from 2007. The other oil boom was starting from 2010 as at that year oil price increased. However, the number declines from 2013 which may be explained by decreased oil price. The second graph shows which percent of state budget constitute these transfers (“Military Expenditure (% of GDP)” 2016).

Figure 6: SOFAZ Transfers to State Budget (million USD)

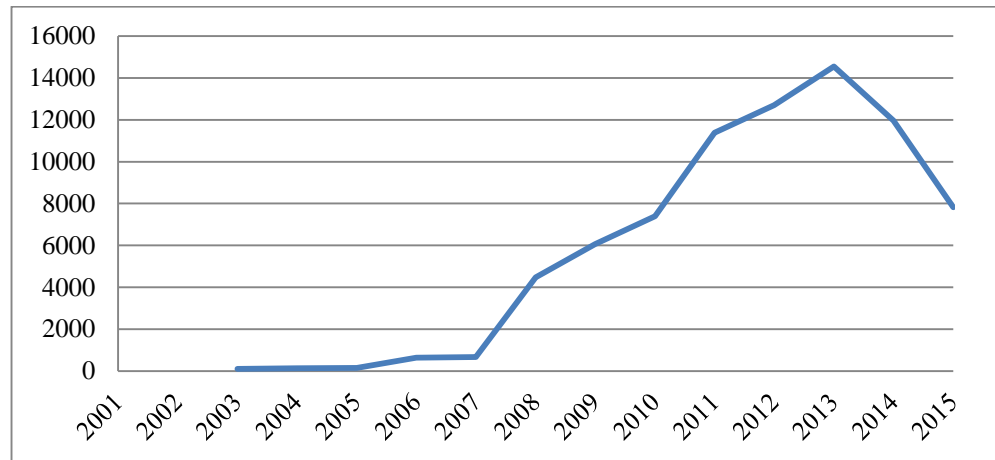
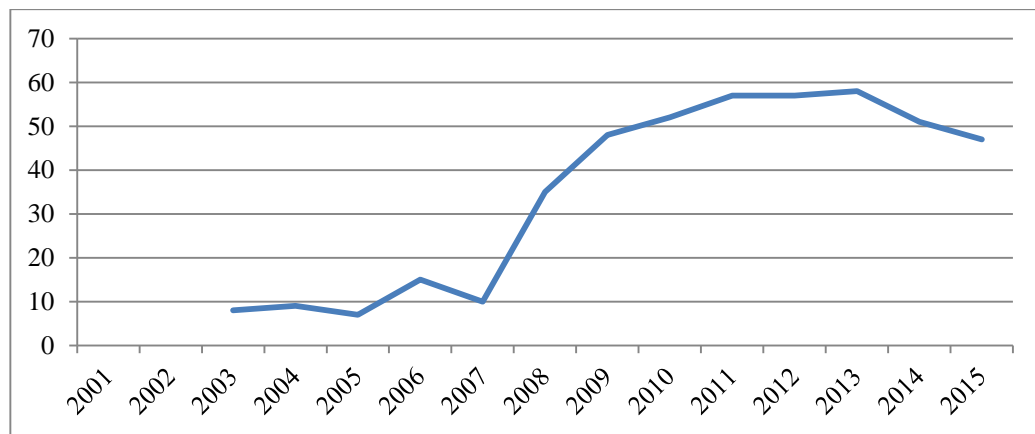


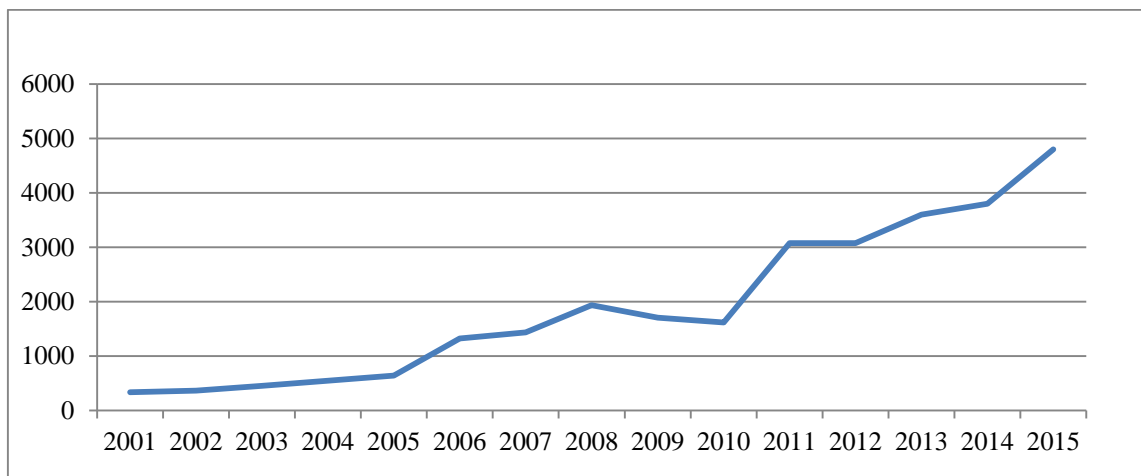
Figure 7: SOFAZ Transfers % of State Budget



It can be assumed that **with higher transfers from SOFAZ, Azerbaijan would have higher military expenditures**. The graph below shows the military expenditures of Azerbaijan from 2001 to 2015 (“Military Expenditure (% of GDP)” 2016) . From the official sources it is nearly impossible to find the official numbers of the military expenditures of Azerbaijan. Nevertheless, we tried to find approximate numbers by comparing several sources and took as a base World Bank data (“Military Expenditure (% of GDP)Graph” 2016) . It is obvious that Azerbaijan has increased its military spending after 2005, which is the major oil boom in the country. However, the other dramatic increase can be notices from 2010 when oil price started to

increase. This might be illustration of aggressive foreign policy and why not, threat to the war with Armenia.

Figure 8: Military Expenditure (million USD)



Besides, as analysis of the speeches of the President of Azerbaijan show, one of the main priorities for the country is to increase its military spending (President.az). Moreover, during the regular meetings with cabinet of Ministers, the President of the country mentioned not once that one of the goals for Azerbaijan was to have bigger military budget than total budget of Armenia (“Official Web-Site of President of Azerbaijan Republic - NEWS » Speeches Opening Speech by Ilham Aliyev at the Meeting of the Cabinet of Ministers Dedicated to the Results of Socioeconomic Development in 2014 and Objectives for 2015” 2016)

*“Suffice it to say that the funds allocated for the military exceed the total budget of Armenia more than twice”
Ilham Aliyev, January 10, 2015 (President.az).*

The scatterplot below shows dependency between military expenditures and transfers from SOFAZ to state budget. Thus more transfers from oil fund lead to more military expenditure. From the R^2 value on the graph it is clear that there is a strong correlation between these two factors. Further, the correlation table shows that there is statistically significant and strong correlation between these variables,

as significance level is less than 0.01. Thus, more oil revenues lead to higher military expenditure. Taking into consideration the fact that Azerbaijan is in ongoing conflict with Armenia, this actions can be explained as it wants to have dominant position in the region.

Figure 9: Regression: Military Expenditure & SOFAZ Transfers

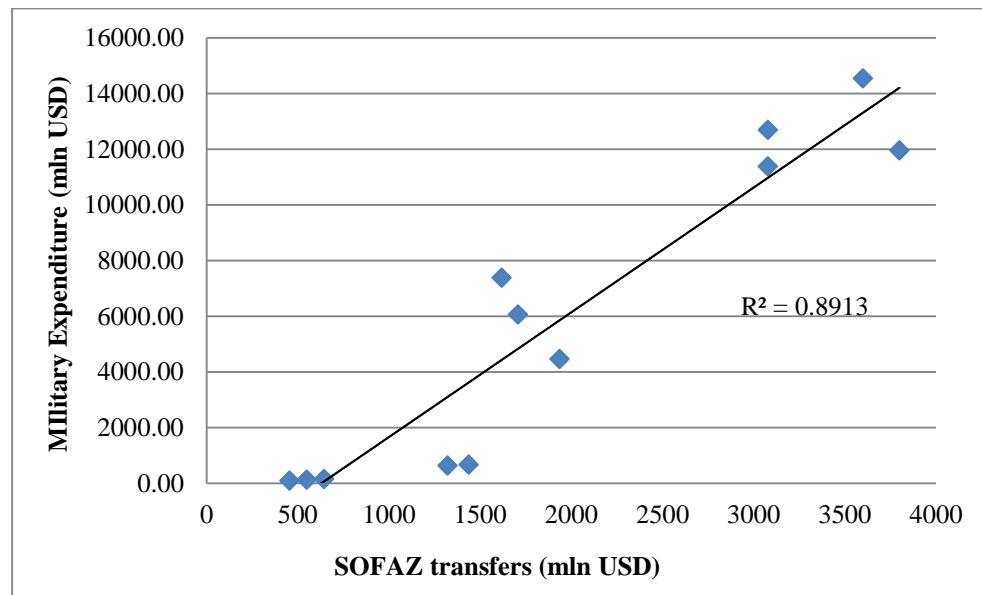


Figure 10: Correlation: Military Expenditure (million USD) & SOFAZ Transfers

(million USD)

Correlation			
		Military Expenditure (mln USD)	SOFAZ transfers (mln USD)
Military Expenditure (mln USD)	Pearson Correlation	1	,944**
	Sig. (2-tailed)		,000
	N	12	12
SOFAZ transfers (mln USD)	Pearson Correlation	,944**	1
	Sig. (2-tailed)	,000	
	N	12	12

** . Correlation is significant at the 0.01 level (2-tailed).

Thus, Azerbaijani brinkmanship towards NK and Armenia can be observed both in its military expenditure and Aliyev's speeches when he repeatedly expresses aim to have **higher military budget than Armenia's total budget**. The actions of Aliyev shows that he pushes for a war at the same time being sure that Armenia will not respond correspondently as both sides will loss for that. However, the four-day war in April 2016 clearly illustrated that NK is more than able to counter respond Azeri army.

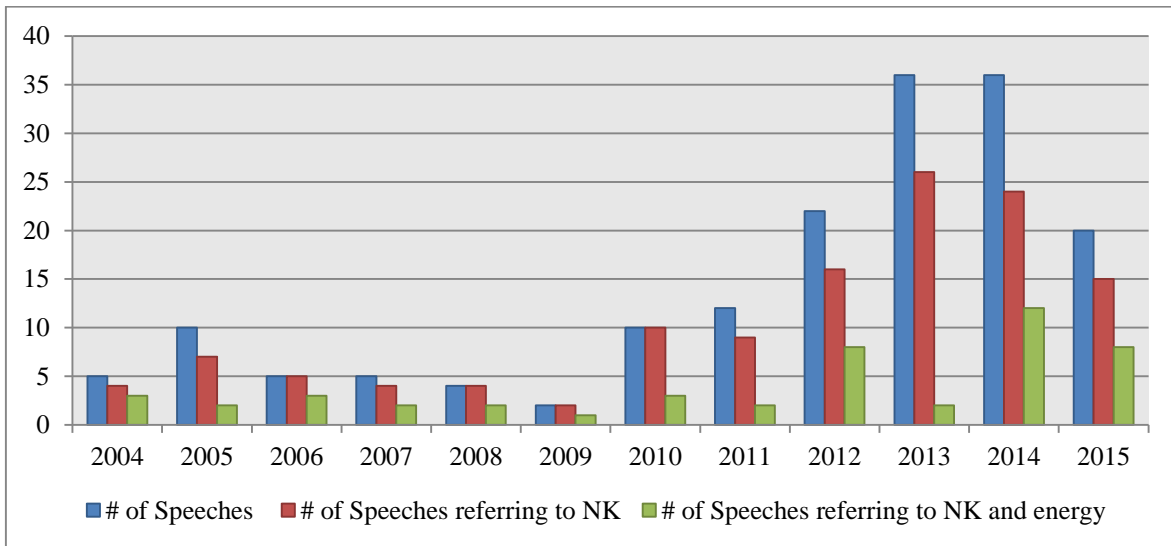
Content Analysis

Nagorno-Karabakh issue has always been a priority for Azerbaijani government and it is clearly illustrated in the speeches of the leaders of the country. This section presents the content analysis of speeches of Azerbaijani President Ilham Aliyev and Minister of Foreign Affairs Elmar Mammadyarov.

The chart below shows the results of content analysis. The 'blue' column represents the total amount of speeches and statements available at the web-site of Ministry of Foreign Affairs from 2004 to 2005, the 'red' one shows the number of speeches and statements that were referring to NK issue. Finally, the 'green' column presents the number of speeches and statements in which Ilham Aliyev or Elmar Mammadyarov referred both on the factor of oil and NK issue. According to the results, we can see that each year in more than 50% of the speeches Azerbaijani officials have been referring to NK issue; which means that it is one of the main priorities in their foreign policy making. What is more, if we pay closer attention to the graph, it can be noticed that in 2015 the speeches referring to NK constitute higher percentage in relation with the total number of speeches in comparison with previous three years. Thus, we can infer that Azerbaijani rhetoric in 2015 was more aggressive. This might have been an alert for upcoming aggression from Azerbaijan that occurred at the beginning of April 2016.

Further, from the green columns it can be noticed that Azerbaijani officials use meetings with their foreign energy partners, to mention once again the NK issue and remind the world that they are the 'victims of the Armenian occupation'. Therefore, the numbers shows that Nagorno-Karabakh conflict has been always one of the emphasizes in Azerbaijani officials speeches and statements.

Figure 11: Number of Speeches Analyzed



Further, to make analysis clearer the research has chosen codes for content analysis and sorted them by categories. The table below shows the categorization of the codes. Only the speeches that were referring to NK issue were analyzed: total of 126 speeches

Figure 12: Content Analysis: Categorization of Codes

Category	Codes		
Territorial Integrity of Azerbaijan	‘occupied territories’	‘liberation’ of ‘occupied territories’	Restoration of territorial Integrity
Armenia as an aggressor	Rejection of UN Four resolutions (other organizations’) on NK by Armenia:	Khojaly events: restoration of ‘justice’	Destruction of Azerbaijani mosques and monuments in NK
Energy	Energy cooperation	Importance of oil	Importance of Azerbaijan to Europe’s Energy security
War statements: Unconstructive resolutions to the conflict	Azerbaijani increased military expenditure	Withdrawal of Armenian armed forces from NK as the only solution	Higher military expenditure than Armenia’s total budget

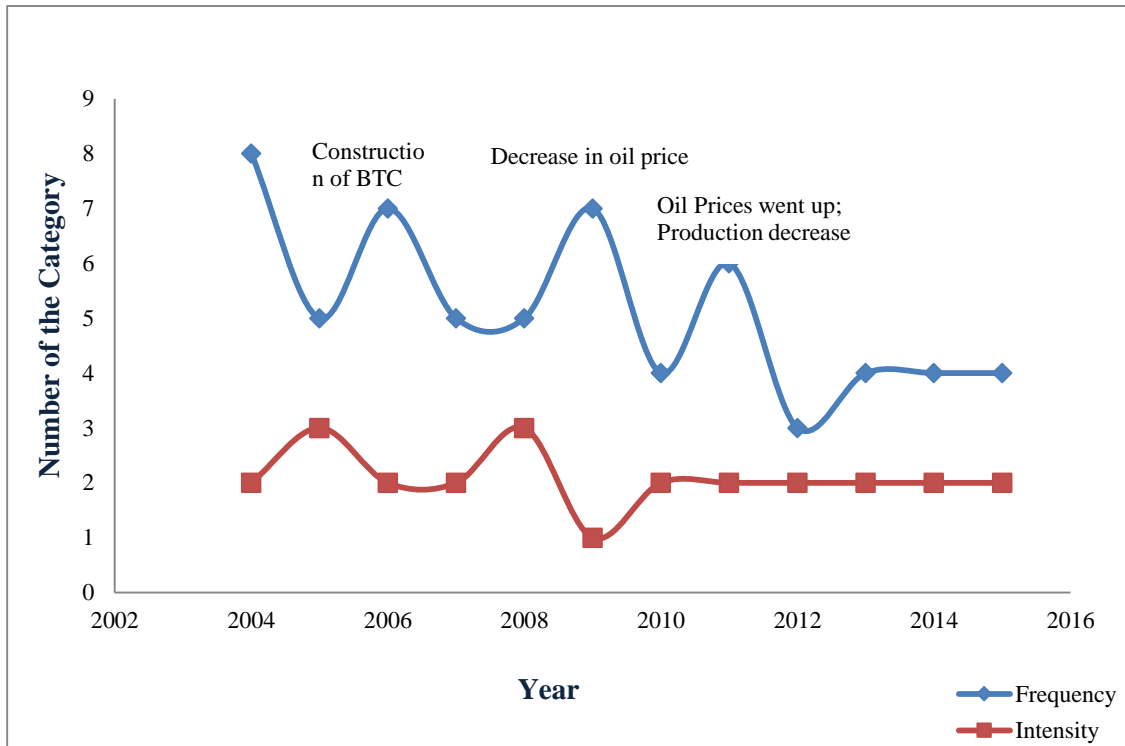
In addition, the frequency and intensity levels of the categories were measured. By frequency the research shows the number of codes appearing per speech. The numbers under frequency level show the mean of the category per speech for the total year. Intensity level was chosen in a scale from 0 to 3, and the description of each level is presented in the table below.

Figure 13: Content Analysis: Description of the Intensity Levels of Codes

0	Mentioned once or twice in passing, not at all important or central for the speech
1	Varying importance at different stages, sometimes not important at all
2	Very important, but not dominant
3	The key argument/focus of the speech

The graph below demonstrates frequency and intensity of the ‘territorial integrity’ category, that shows how many times and in what intensity Azerbaijani officials were referring to NK as their ‘occupied’ territories and were claiming that they will restore their ‘territorial integrity’. From the graph we can see several peaks and troughs. It is evident that the frequency level for the code increased in 2006, which is the year when BTC started to operate and carried first oil to Ceyhan (“Baku-Tbilisi-Ceyhan Pipeline | Pipelines | Operations and Projects | BP Caspian” 2016b). Another peak can be noticed in the year of 2008 and 2009, which might be due to decreased oil price, as at that year oil price dropped to 61 USD from 94 USD. The other reason for this rhetoric might be Armenian-Turkish rapprochement and signed protocols in Zurich, which, however, Turkey rejected to implement (“Turkey - Bilateral Relations - Ministry of Foreign Affairs of the Republic of Armenia” 2016). Another peak of this category can be noticed in 2011, which might be connected with increased prices on oil (107 USD per barrel) (“OPEC Crude Oil Price Annually 1960-2016 | Statistic” 2016).

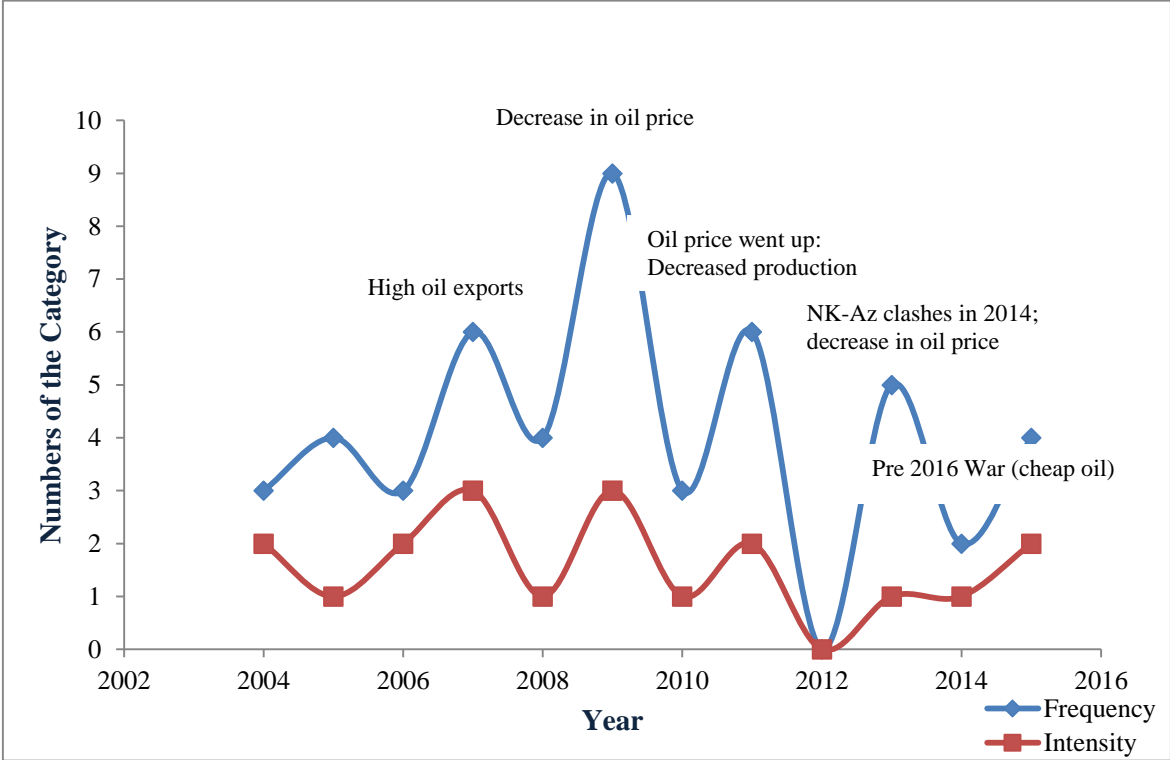
Figure 14: Code 'Territorial Integrity': Frequency and Intensity level



The other graph demonstrates the frequency and intensity level for the category ‘Armenia as an ‘aggressor.’’ According to the results, Azerbaijani officials were referring to this category quite often in 2007 with frequency ‘6’ and intensity level ‘3’. This was a year after BTC final construction, which means Azerbaijani oil exports increase drastically this year. Hence, it is possible that higher revenues from oil have resulted in more references to Armenia’s ‘aggressiveness’. Again another increase for this category is in 2009 that might be connected with the decrease in oil price. However, it might also be connected to the Armenian-Turkish rapprochement. Further, the other year, when this category was appearing in speeches is 2011; again it was the period when oil price increased significantly. On the other hand, the other Azerbaijani oil production started to decrease that year from around one million barrels per day to 916 million. The other peak in the graph is in the year of 2013; starting from 2014 oil price began to fall; if in 2013 it was 106 USD per barrel in 2014 the cost for one barrel of oil was 96 USD.

This might also be a reason for this rhetoric and also aggressiveness of Azerbaijan as in 2014 there were major clashes between NK and Azerbaijan (*The Economist* 2014). The other increase both in intensity and frequency can be noticed in 2015, when oil prices drastically decreased. What is more, this might be a warning for the war that occurred at the beginning of April 2016 (“RIAC: A Little War That Didn’t Shake the World: A View from Yerevan” 2016).

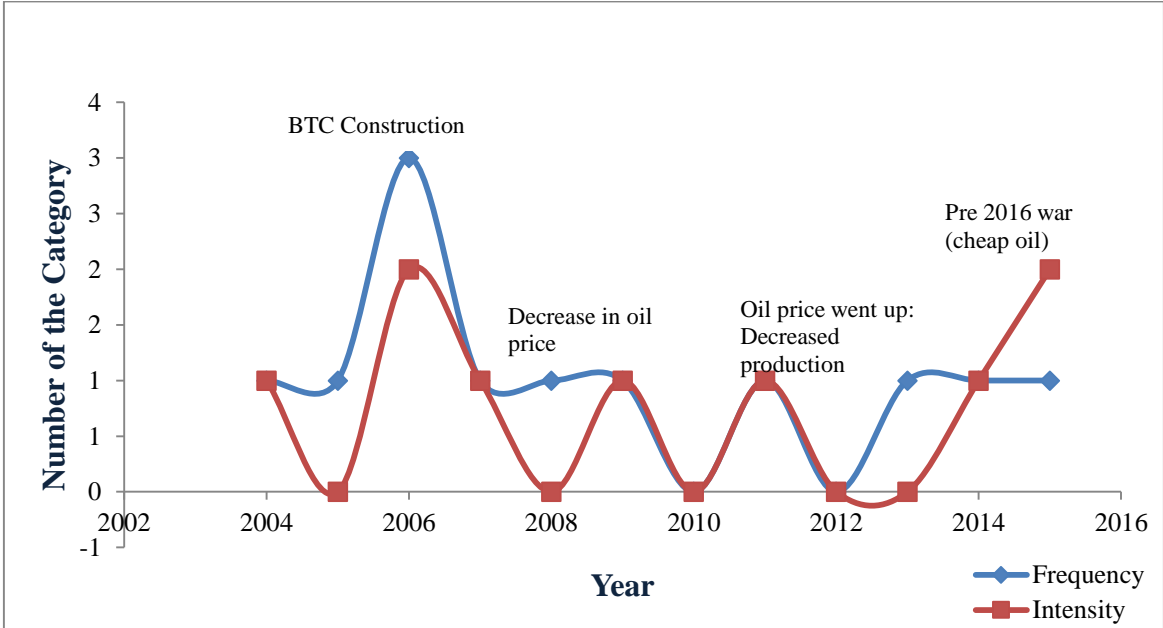
Figure 15: Category ‘Armenia as an ‘Aggressor’’: Frequency and Intensity level



The graph below summarizes the results of the war statements made by Azerbaijani officials from 2004 to 2015. Again the picture is similar to the previous two graphs. It can be noticed that in 2006 which is the year of BTC construction, both intensity and frequency of this category is high. Thus, it might be argued that higher oil revenues lead to more statements from Azerbaijani officials. Then these statements decreased and again increase in 2009, as in the case of previous codes. Again another increase can be noticed in 2011, which is the year of high oil price

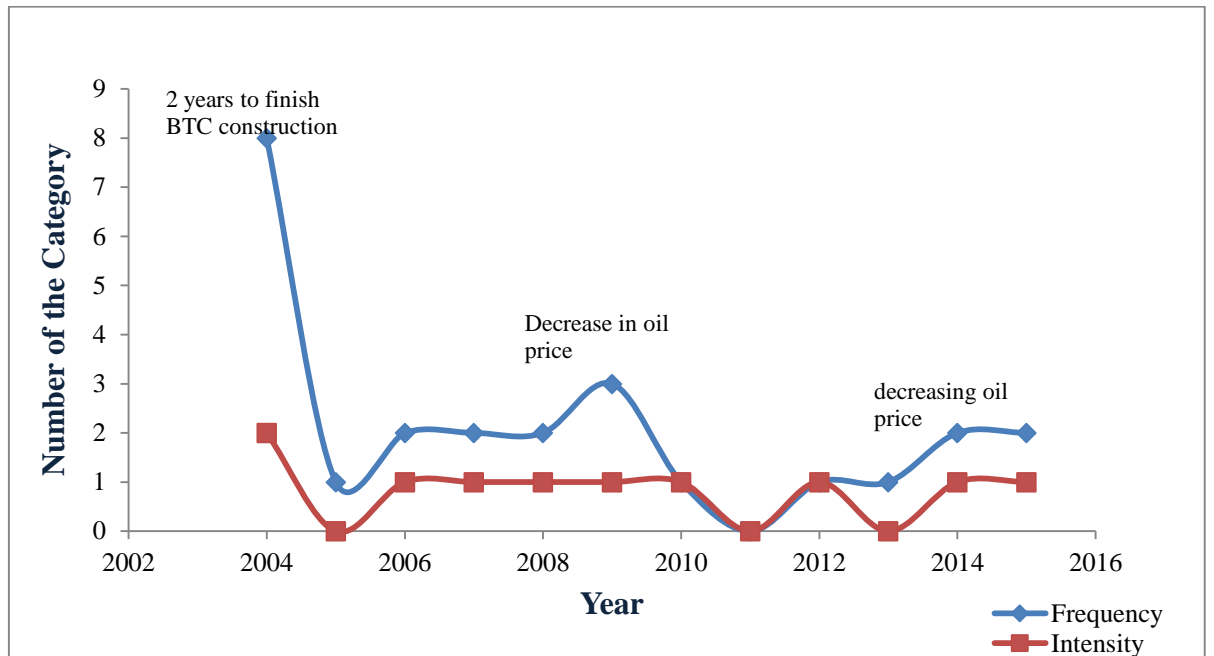
and when Azerbaijani oil production started to decrease. Finally, there is a sharp increase of intensity level in 2015, which reached to level '2', which, from previous years have been only in 2006. Thus, cheap price for oil might have led to higher level of war statements.

Figure 16: Category 'War Statements': Frequency and Intensity level



The graph below illustrates the results for the code 'energy', that is the number of times when Azerbaijani officials were pointing how energy and energy cooperation is important for Azerbaijan as well as for European countries. Naturally, before the construction of BTC the intensity and frequency of this code was quite high. Further, another peak can be noticed in 2009 and 2014, which might be connected with decreasing oil price, so that officials need to point that Azerbaijan is essential for energy market despite the falling oil prices.

Figure 17: Category 'Energy': Frequency and Intensity Level



To conclude content analysis of the speeches has demonstrated that Azerbaijani rhetoric on NK and Armenia becomes more aggressive with any significant change in oil price as well as oil production. Hence, it can be argued that oil factor affects Azerbaijani leaders' rhetoric, that are the main actors in country's foreign policy making. Therefore, oil factor may also affect Azerbaijan's foreign policy towards Armenia and NK.

Interview Analysis

Interview analysis with two NK diplomats in European states, three experts on regional studies and two on energy politics were conducted to measure the possible role that oil may play in Azerbaijan's foreign policy formation and how oil factor is likelier to affect Azerbaijan's position towards NK issue. The main points discussed by interviewees are summarized below.

Aliyev's Regime Survival

Some of the interviewees argued that one of the primary objectives of Aliyev's regime is to preserve its stability and remain in power, which is mainly possible by using financial resources. On the other hand, a significant part of these resources comes from oil revenues (NKR Diplomat 2 2016; NKR Diplomat 1 2016; Expert on Energy Politics 1 2016; Expert on Energy Politics 2 2016). What is more, one of the interviewees argued that Aliyev's government is "in need of aggressive policy towards Armenia and NK", which helps the regime turn public attention from domestic issues such as corruption and fraud, despotism, unemployment, lack of basic human rights, misallocation of public resources and other problems at home (NKR Diplomat 2 2016). The regime uses NK conflict to hide a real situation in Azerbaijan and to initiate an anti-Armenian campaign. Baku raised xenophobia against Armenians to create an enemy image for domestic consumption. It is not interested in real negotiations and peaceful resolution of Karabakh conflict. The continued provocations of Baku on the Line of Contact between NK and Azerbaijan, as well as on the Armenian-Azerbaijani border are widely proving this point. Economically vulnerable Azerbaijan under Aliyev's regime might restart a war against NK to avoid social protests and removal from power (NKR Diplomat 2 2016; Expert on Regional Studies 3 2016).²

² Note: These interviews were conducted before the four-day war in April, 2016.

Oil in Azerbaijan's Foreign Policy Formation

The majority of the interviewees argued that oil factor is determinant in Azerbaijan's foreign policy formation (NKR Diplomat 1 2016; NKR Diplomat 2 2016; Expert on Energy Politics 1 2016; Expert on Regional Studies 2 2016). Some of them claimed that Azerbaijan is one of the large consumers of international lobbying practice, where money from energy contracts is channeled for lobbying in other countries; the practice widely known as 'caviar diplomacy.' The main objectives of their lobbyists include improvement of Azerbaijan's (Aliyev) image abroad and enhancement of anti-Armenian policy. Hence, oil is the most if not the only important tool in the formation of Azerbaijan's foreign policy as well as domestic policy (NKR Diplomat 1 2016; NKR Diplomat 2 2016).

One of the diplomats pointed that there are numerous Azerbaijani companies abroad that are officially financed by SOCAR and they often thank Azerbaijani government for the support they get from SOCAR (NKR Diplomat 1 2016). Besides, in every occasion on meetings on energy cooperation, Azerbaijani leaders spend from 3-4 minutes to speak about NK conflict and point once again that Armenia is an 'aggressor' that 'occupied territories of Azerbaijan.' Thus, the interviewee argued that if Azerbaijan has fewer oil resources, the occasion for speaking up will be less (NKR Diplomat 1 2016).

Changes in Azerbaijan's Foreign Policy after BTC construction

Another argument pointed by interviewees is that after the BTC construction, Azerbaijani foreign policy became more aggressive causing

"Azerbaijani lobby had initiated a program in 2015 to urge citizens in the streets of Berlin to sign a petition to accept Khojaly events of February 1992 as 'Genocide' offering one euro for each signature" (Interview with NKR Diplomat 1 April 2, 2016).

instability in the entire region (NKR Diplomat 1 2016; NKR Diplomat 2 2016; Expert on Energy Politics 1 2016; Expert on Regional Studies 1 2016). Besides, a huge amount of oil exports let Azerbaijani government to be more independent in foreign policy making and less dependent on Russia (NKR Diplomat 1 2016; Expert on Regional Studies 2 2016). What is more, by using oil revenues from exports, Azerbaijan also increased its military expenditure becoming one of the main consumers of Russian military (NKR Diplomat 2 2016; Expert on Regional Studies 1 2016).

Cheap Oil's Effect on Azerbaijan's Foreign Policy

The other argument was that low oil prices can even result in a more aggressive behavior from Baku (NKR Diplomat 1 2016; NKR Diplomat 2 2016; Expert on Regional Studies 1 2016). Facing a real risk of social protest in a result of economic collapse due to low oil prices, Baku can escalate the situation on the borders with Armenia and NK to justify domestically its failed policy. Hence, low oil revenues may move Baku towards more provocative and dangerous policy that may threaten the security and stability of the entire region. However, it low oil price may also significantly reduce Baku's ability for buying additional offensive weapons from other countries (Expert on Energy Politics 1 2016).

Another interviewee pointed that with the declining oil revenues, international support for Azerbaijan decreases, as nowadays we can see more Azerbaijani criticism in Western media, which, due to Azerbaijani lobbies' efforts might have not been spoken up before (NKR Diplomat 1 2016).

Possible Developments in Nagorno-Karabakh conflict

The majority of the interviewees argued that both cheap and expensive oil may result in more aggressive foreign policy regarding NK. While economically stable Azerbaijan under the

same regime spends billions and billions to buy military weapons, economically weak Azerbaijan will have an incentive to start military aggression and shift domestic attention from the problems at home(NKR Diplomat 1 2016; Expert on Regional Studies 1 2016). However, low oil revenues will have effect in a long-term foreign policy formation as Azerbaijan will not have enough financial resources to buy military and gain international support. Thus, it will reconsider its foreign policy towards milder stance (Expert on Regional Studies 2 2016).

Conclusion

The paper has analyzed Azerbaijan's foreign policy developments since 2003; particularly concentrating on the role of oil in the formation of the country's foreign policy formation towards NK conflict. The study took the year of 2003 as a starting point for analysis because it was the date of change of the leadership in Azerbaijan (Ilham Aliyev succeeded Heydar Aliyev), and three years later BTC pipeline became operational which paved the way for Azerbaijan to enter the European market. Consequently, the aim of the research was to find out whether there were any changes in Azerbaijan's foreign policy with the variations in oil revenues.

Three distinct tools were used to evaluate the influence of the oil factor on Azerbaijan's foreign policy. Firstly, the data on the oil revenues is correlated with the military expenditure of the country. Secondly, the analysis of the speeches of the Azerbaijanis officials was done in the light of drastic oil revenue changes. Third, the interviews with experts as well as diplomats revealed the correlation between oil revenues and country's foreign policy.

According to the findings, revenues coming from oil are positively correlated with the military expenditure of Azerbaijan. The expansion of the military expenditure speaks about the aggressive position of Azerbaijan towards Armenia and NKR and its stance of preparing for a war. In addition, Azerbaijani officials do not hide the fact that they increase their military spending so that to exceed Armenia's total budget, therefore showing Armenia that they are prepared better for any military act.

Furthermore, content analysis of Azerbaijani officials' speeches for the last twelve years has shown that Azerbaijani rhetoric on NK conflict becomes more aggressive with both drastic increase and decrease in oil prices and also with changes in oil production. Thus, both high and low revenues from oil lead to more aggressive rhetoric toward NK and Armenia from the Azerbaijani side.

In addition, interview analysis has demonstrated that oil revenues are responsible for Azerbaijan's so-called 'caviar diplomacy,' as they provide a great amount of petrodollars necessary for foreign lobbying. As it was demonstrated, the primary objective of their foreign lobbying is to increase Azerbaijan's image in the international arena and enhance anti-Armenian foreign policy, by trying to present Armenia as an 'aggressor' that have 'occupied' its territories. On the other hand, low oil revenues also result in aggressive foreign policy. The main reason is that low oil revenues create **economic challenges** at home and put at risk the legitimacy of the ruling party. Consequently, in order to shift the public attention, Aliyev revives the Karabakh discourse.

It should be noted that both low and high oil revenues make Azerbaijan's foreign policy more aggressive in mutually exclusive ways: in case of high revenues Azerbaijan spends many financial resources on its military and 'caviar diplomacy'; whereas decreasing oil revenues make Azerbaijan's foreign policy aggressive as the leadership of the country needs to shift public attention from domestic issues such as unemployment, devaluation of national currency, legitimacy issues. Thus, the creation of an external enemy image in the face of Armenia is one of the safe and experienced ways for Azerbaijani leadership to preserve its power. Accordingly, it can be argued that the significant decrease in oil price in 2015, that created numerous social and economic issues in Azerbaijan, might be responsible for the four-day War between Azerbaijan and NKR along the entire Line of Contact with NKR at the beginning of April 2016

To conclude, oil revenues enable Azerbaijani leaders to utilize vastly 'brinkmanship' in their foreign policy towards NK and Armenia. Through 'caviar diplomacy' the ruling elite could afford to spread its aggressive foreign policy without receiving much condemnation from the international community. However, with less international lobbying the West becomes more critical towards Azerbaijan's authoritarian regime and mass violations of human rights.

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Appendices

Interview Questions

- 1) In your opinion what role does oil have in the formation of Azerbaijan's foreign as well as domestic policy?
- 2) How would you describe the change (if any) in Azerbaijan's foreign policy after the Baku-Tbilisi-Ceyhan pipeline started to operate? How has it affected the overall strategy of Azerbaijan regionally and internationally since then?
- 3) Some experts claim that the vast cash flow from oil export has been fueling Azerbaijan's foreign policy to become more assertive and aggressive, the more visible side of it being the significant arms acquisitions from Russia and elsewhere. Do you think Azerbaijan will revise or reconsider its foreign policy strategy towards Armenia and Nagorno Karabakh if the oil prices continue to remain in the lower \$40's in mid-term?
- 4) In general, can the low price of oil affect Azerbaijan's position on Nagorno-Karabakh conflict?
- 5) In your opinion is the progress in negotiations on Nagorno-Karabakh more possible in case of cheap oil and weaker Azerbaijan or expensive oil and economically stronger Azerbaijan?