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The collapse of the Soviet Union has proven that command economies are unable to use economic resources efficiently. Therefore, former Soviet countries, including the Azerbaijan Republic, after gaining independence have started to implement reforms for transitioning to a market economy. In Azerbaijan one of the main economic reform goals is to participate in the international market and create effective bilateral economic relations with economically developed countries. From this point of view, the development of political and economic relations and collaboration with the United States of America is considered priority. In this *Economics Commentator* we provide an overview of economic relations between the United States of America and Azerbaijan and opportunities for development and strengthening collaboration.

Background

The Azerbaijan Republic gained independence October 18, 1991 from the former Soviet Union. The country is situated 44^o and 52^o east longitude, 38^o and 42^o north latitude. Total area is 86.6 thousand square kilometers. At the beginning of 2006, the population was 8.5 million people. Azerbaijan's border with Russia in the north is 390 km of the country, in the north-west with Georgia is 480 km, in the west with Armenia is 1,007 km, in the south west with Turkey is 15 km and in the south with Iran is 765 km. The widest area of the Azerbaijan section of Caspian Sea is 456 km.

In 2006 GDP per capita was \$ 2,373.3; annual total trade turnover was \$ 11.6 billion, of which \$ 6.3 billion was exports and \$ 5.3 billion was imports. 57.5 percent of GDP production is in the oil and gas sector, 7.5 percent in construction, 6.9 percent in agriculture, hunting and related services, and 28.1 percent in other sectors. Presently Azerbaijan has trade relations with more than 130 countries of the world, including the United States of America.

Figure 1. Map of the Azerbaijan Republic



The independence of the Azerbaijan Republic was recognized by the United States on December 25, 1991 and diplomatic relations were established on February 28, 1992. A significant part of economic relations between both countries is concentrated in

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the oil sector. Particularly, current international oil market conditions have accelerated and increased the importance of these relations.

Economic relations on oil sector

Azerbaijan has rich oil and gas resources. After gaining independence it became important to invite foreign investors to the country for oil and gas exploration and production. On September 20, 1994 a contract was signed between 13 oil companies, including AMOCO, BP, McDermott, UNOCAL, SOCAR, LUKOIL, Statoil, Exxon, Turkish Petrol, Pennzoil, Itochu, Remco, and Delta. It was called the “contract of the century” due to its historical, political and international importance. Since that time economic relations between the United States of America and Azerbaijan started increasing rapidly.

From 2000 to 2006 total amounts of foreign investments increased from \$ 927.0 million to \$ 5,022.8 million (5.4 times), of which oil sector investments rose from \$ 546.0 million to \$ 3,422.3 million (6.3 times). During this period investments from the U.S. companies and joint ventures increased 6.25 times or from \$ 11.2 million to \$ 70.0 million.

United States companies are participating in one of the important projects, the Baku-Tbilisi-Ceyhan main oil export pipeline. The length of this pipeline is 1,767 km, of which 443 km are in Azerbaijan, 248 km in Georgia and 1,076 km in Turkey. (See Figure 2.) Total worth of the project is estimated at more than \$ 4 billion. Annual capacity of the pipeline is 50 million ton or 1 million barrels per day. The pipeline is an international project designed for the transportation of crude oil, produced from the oilfield located in the Azerbaijan sector of the Caspian Sea, to international markets.

In this project the United States oil company’s share- Chevron (Unocal) is 8.90 % and ConocoPhillips is 2.5 %. Besides, Chevron (10.28 %), Exxon/Mobil (8 %), Devon Enerqu (5.63 %) and Delta Hess (with Saudi Arabia) (2.72 %) share the “Azeri-Chirag-Guneshli” (ACG) project in the Caspian Sea. The contractual area of the project is about 432.4 square kilometer. Presently, oil resources of the field are estimated to be 1.0 billion

Figure 2. Baku-Tbilisi-Ceyhan main oil export pipeline.

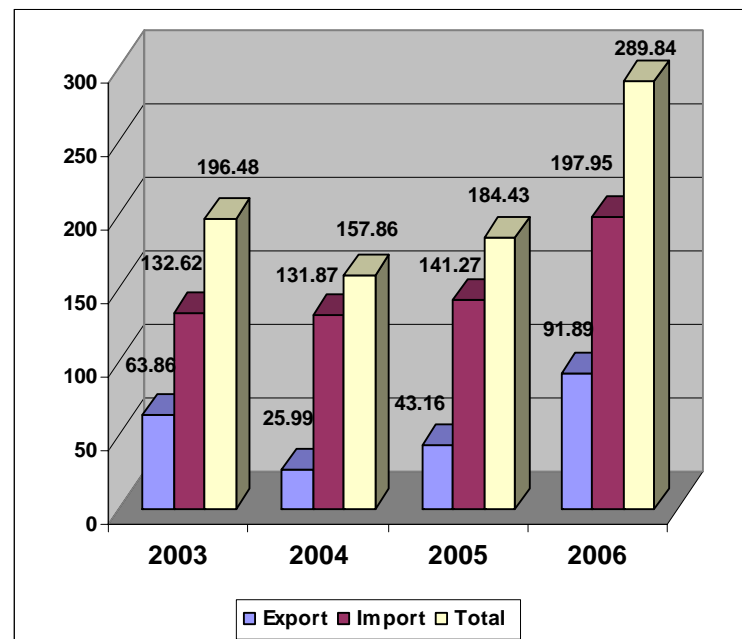


tons of nominal fuel unit. Total investment for the contract is about \$ 15 billion. The ACG is one of the largest fields under development in the country.

Foreign trade

Regarding foreign trade between the United States and Azerbaijan, the total amount of turnover has increased compared with previous years. In 2006 the structure of the Azerbaijan proportion of the United States foreign trade was 2.5 %, of which imports were 3.8 % and exports were 1.4 % (see Figure 3).

Figure 3. Foreign trade between Azerbaijan and the United States of America (million of U.S. dollars)



Azerbaijan has a negative foreign trade balance with the United States of America. For example, in 2006 imports were \$ 197.95 million, exports were \$91.8 million and trade balance was negative \$106.6 million. In structure of exports from the U.S. to Azerbaijan included: equipments, mechanical installations and their parts \$ 86.523 million (43.7 %), ferrous metal products \$ 21.409 million (10.8 %), chemicals \$ 13.085 million (6.6 %), pharmacy products \$ 4.621 million (2.4 %) and other products \$ 72.312 million. The United States of America imports from Azerbaijan mainly oil and petroleum products and in 2006 the proportion of these products were 96 %. From this point of view, to diversify the structure of exports is considered one of main economic policy priorities of Azerbaijan.

Economic relations between both countries are not entirely between private companies. Moreover, at the state level, the United States Government Agencies in different fields assist Azerbaijan. An estimated \$ 48 million is budgeted by all U.S. Government agencies for assistance programs in Azerbaijan. In the fiscal year 2006, these government funds were allocated roughly as follows: Democracy Programs-\$ 10.3 million; Economic and Social Reform-\$ 22.7 million; Security and Law Enforcement \$ 9.75 million; Humanitarian Assistance \$ 3.7 million; and Cross Sectoral Initiatives-\$ 1.5 million. In particular, assistance for private sector development programs aim to encourage growth of small and medium enterprises by making credit available, providing business consulting and training, and rehabilitating productive infrastructure in country. Particular attention is paid to supporting key areas of fiscal planning, especially the development and implementation of public investment management and accountability.

Opportunities in agricultural sector

Diversifying the structure of the Azerbaijan economy also requires attracting investments from the United States to non-oil sectors, including the agricultural sector of the economy. The country has a favorable agricultural potential, including agriclimate diversity, fertile land, relevant geographic position, cheaper labor resources, possibilities for developing organic farming, and active agricultural policy. Since 1999 agricultural producers of the country are free of taxes (excluding land tax) and the government allocates financial resources for subsidizing oil and fertilize prices.

Approximately 7 % of the Azerbaijan economy is from the agricultural sector. But each year this sector declines as a portion of national GDP. The proportion of domestic investment going to the agricultural sector is very low. Thus, the agricultural sector has problems attracting foreign agribusiness investors. Particularly, establishing joint enterprises in the processing sector of agricultural products could be a priority and create a comparable advantage for both countries. United States agribusiness companies could benefit from using cheaper economic resources and exporting processed agricultural products to the international markets.

Due to lack of modern technology and processing plants, agricultural products are exported to the Russian market as raw material and then imported back to Azerbaijan as food products. Food is approximately equal to 10 percent of total imports. From this context, investments to agribusiness sector play a vital role for maintaining food security of the country. Simple value added food processing plants could create profit potential for international investors.

Concluding Remark

Economic relations between the United States and Azerbaijan are developing and serve economic interests of the both countries. But there are many unrealized opportunities for further development and strengthening economic relations between the United States and Azerbaijan.

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