

2.0 PURPOSE AND BENEFITS OF THE PROJECT

Summary

The countries along the pipeline route are all experiencing significant economic difficulties. Whilst Turkey enjoyed considerable economic growth during the 1990s, it entered a severe recession in 1999 coupled with a currency crisis, and faces further problems as it strives to develop its industrial base and reform and modernise its economic institutions. Azerbaijan and Georgia have very low per capita incomes and face difficult structural challenges as they move from a highly centralised Soviet planned economy to becoming independent market economies.

Poverty is a significant concern in all three countries and the complex political history and ethnic and religious make-up of the region contribute to the economic vulnerability of much of the population.

The Caspian region has the potential to become one of the major oil and gas producing areas of the world. Azerbaijan in particular is forecast to see enormous growth in oil production over the next five years as a result of the development of the Azeri-Chirag-Gunashli (ACG) oil field in the Caspian Sea, which has reserves of over five billion barrels. The development of these reserves can make a major contribution to the economic stability and growth of the region.

The existing oil export infrastructure of this land-locked region is now operating near the limits of its capacity however, and this threatens to constrain further exports of hydrocarbons from Azerbaijan and the ACG field in particular. The BTC pipeline is intended as a solution to this issue and will provide additional export capacity of one million barrels of oil per day - the planned maximum output of the ACG field.

The overall development of the ACG oil field, and the associated BTC pipeline, will provide significant benefits to the economies of Azerbaijan, Georgia and Turkey. These include the direct financial benefits of tax revenue and infrastructure investment and indirect benefits associated with strengthening the countries' capabilities and institutions. It is also anticipated that there will be local benefits to the communities directly affected by the pipeline development, including: the outputs from the project's social, community and environmental investment programmes, employment and procurement of local goods and services, enhanced recruitment and contracting practices, enhanced local experience and employment, and improvements to infrastructure and service provision.

2.1 *Regional socio-economic background*

2.1.1 **The economies of Azerbaijan, Georgia and Turkey**

2.1.1.1 *Overview*

Azerbaijan, Georgia and Turkey have all experienced significant economic difficulties in recent years, although the nature of their economies is very different. Turkey is a large, emerging economy that has experienced a transition from an agrarian to an industrialized economy, resulting in a long-term pattern of rural to urban migration, increasing overall wealth, and industrial and commercial development. Turkey now ranks as the world's 17th most industrialised nation, with an average per capita income of approximately \$3,000 and a population of over 66 million. During the 1990s, the economy grew at an annual rate of about 4%. In 1999, however, the country entered into a severe recession that was coupled with a currency crisis. There are also marked regional disparities in Turkey. For example, all provinces traversed by the pipeline, with the exception of Adana, have levels of Gross Domestic Product (GDP) per capita that are below average for Turkey. The north eastern five provinces are particularly poor. Income levels generally increase along the pipeline route, with residents in central and southern sections of the pipeline (e.g., Kayseri, southern Kahramanmaras and Adana) being relatively wealthier than those in Central and Eastern Anatolia. In line with its aspirations to join the EU, Turkey has established a national programme of action focusing on establishing a stable macro-economic environment and strengthening its democratic system.

Azerbaijan and Georgia, by comparison with Turkey, are low-income transition economies facing difficult structural challenges as they move from a highly centralised Soviet planned economy to a market economy. The years following the dissolution of the Soviet Union in 1991, and the re-establishment of national independence, have been characterised by political and economic turbulence. Azerbaijan has a population of about eight million, with a per capita income in 1999 of around \$500 (having dropped 55% from 1991-1997). Georgia has a population of five million with a per capita income of approximately \$620. These indicators rank both countries as amongst the poorest in the world, although GDP has risen since the mid-1990s as the economies have stabilised.

The oil sector has a very long history in Azerbaijan, and has made a significant contribution to the local economy. Oil and gas accounted for 31% of GDP and one-third of all government revenues in 2001. The Georgian economy has historically been more diverse, based on tourism, agriculture, mining and some manufacturing industry. Georgia is now emerging as a key transit country for oil and gas exports.

2.1.1.2 *Foreign Direct Investment*

A steady flow of Foreign Direct Investment (FDI) is critical to the developing economies of Azerbaijan Georgia and Turkey, in order to finance key projects and to enhance competitiveness by transferring technology and skills. Levels of FDI in Azerbaijan averaged around \$660 million per year between 1994 and 2000, whereas FDI in Georgia has declined in recent years to only \$62 million in 2001. FDI in Turkey was estimated at \$982 million in 2000.

The total investment required to realise all of the projects associated with the oil and gas from the Azeri-Chirag-Gunashli and Shah Deniz Caspian Sea fields, of which the BTC project represents one important component, will be of the order of \$20 billion. Consequently, levels of direct investment are expected to increase substantially in all countries concerned as these projects are implemented.

2.1.1.3 *The Role of International Financing Institutions*

International Financing Institutions (IFIs) continue to play a crucial role in supporting the development of competitive economies in Azerbaijan, Georgia and Turkey. Much of the funding provided has been tied to the implementation of structural reforms, for example associated with fiscal arrangements, improving the legal framework for private sector development and combating corruption. Recent funding includes:

- Azerbaijan:*
- a financing agreement under the International Monetary Fund (IMF) Poverty Reduction and Growth Facility in 2001, tied to performance on a range of issues, including structural reform criteria, customs reform and energy sector reform.
 - a \$60 million structural adjustment credit approved by the World Bank in 2002, geared towards enhancing public sector efficiency and accelerating growth of the non-oil sector.
 - World Bank loans to Azerbaijan have totalled \$521 million since 1992.
- Georgia:*
- a three-year Poverty Reduction and Growth Facility amounting to \$141 million, approved by the IMF in 2001.
 - a \$60 million structural adjustment credit from the World Bank in 1999, aimed at supporting the government's reform programme and helping to complete the process of market liberalisation.
 - World Bank loans to Georgia have totalled \$648 million since 1992.
- Turkey:*
- a \$16 billion IMF pact to support a programme to secure the economy against future crises and to secure the reform agenda, particularly in relation to the financial and corporate sectors.
 - a \$1.35 billion financial and public sector loan from the World Bank in 2002, to fund reform and social programmes.
 - the current World Bank Country Assistance Strategy for Turkey envisages commitments of up to \$5 billion over 2001-2003.

2.1.2 **Society**

2.1.2.1 *Overview*

The region has been described as *"a mosaic of ethno-cultural diversity, divided along linguistic, racial, tribal, religious and regional dimensions"*.

Azerbaijan is predominantly Azeri by ethnicity and Muslim by religion. The small Armenian minority now lives almost wholly in the enclave of Nagorno-Karabakh. The constitution of Azerbaijan allows for the protection and development of ethnic minority culture and languages, and for individuals to practice their religion without restriction. Political parties based expressly on religion or ethnicity are not permitted.

Of the three countries, Georgia has the most diverse ethnic and religious structure. Seventy per cent of the population is Georgian, mostly Georgian Orthodox Christian, with the remainder comprised of a mix of ethnic and religious groups, including 11% who are

Muslim. The profile of the communities along the BTC pipeline route includes households who describe themselves variously as ethnically Georgian, Azeri, Armenian, Greek, Russian and Belorussian. The constitution of Georgia allows for the protection and development of ethnic minority culture and languages, and for individuals to practice their religions without restriction. State schools provide education in the dominant language of an area. Political parties based expressly on religion or ethnicity are not permitted.

In Turkey, the dissolution of the Ottoman Empire, and the founding of the Turkish Republic in 1923, created a state modelled on the nation states of Europe, embodying the principles of republicanism, nationalism and secularism. Turkey is reported to be over 99% Muslim, with a population estimated to be 80% Turkish and 20% of Kurdish origin. The 1982 Constitution of Turkey does not provide specific rights to minorities, although the 2001 constitutional amendments removed references to “language prohibited by law”. Political parties based explicitly on ethnicity or religion are not permitted. Turkey’s candidature for membership of the EU is a major driver of its engagement with international organisations. Under the EU Accession Partnership process, Turkey is required to progressively implement EU legislation across a wide range of policy areas including the economy, social protection, human rights and environmental protection.

2.1.2.2 Poverty and vulnerability

Poverty is a significant issue in all three countries. Recent studies have indicated that 60% of the Azerbaijani and Georgian populations should be considered poor; while in Turkey over one third of the population is considered to be economically vulnerable. Poverty levels are stable in Azerbaijan, rising in Georgia and falling in Turkey. Access to water and electricity is limited in most rural areas along the pipeline route and levels of sanitation are generally poor.

In Azerbaijan and Georgia, the education, health and social welfare systems deteriorated sharply in the 1990s. In Turkey, access to education and healthcare has been increasing; for example, compulsory primary school education was increased in 1997 from five to eight years, and school enrolment and life expectancy have risen. However, since 1975, regional inequalities have increased with standards in most developed provinces rising faster than those elsewhere.

2.2 Purpose of the project

The Caspian region has the potential to become one of the major oil and gas producing areas of the world. Estimates of oil and gas reserves range from 17 to 33 billion barrels, compared with proven reserves in the USA of 29 billion barrels and in the North Sea of 15 billion barrels. As production from traditional areas declines, new sources of hydrocarbons, particularly from non-OPEC countries will become increasingly important to the world’s economy.

Azerbaijan is due to see enormous growth in oil production over the next five years, primarily as a result of the development of the giant Azeri-Chirag-Gunashli (ACG) oilfield, that lies about 100km off the coast of Baku and has estimated recoverable reserves of 5.4 billion barrels. The first phase of the ACG development – the “Early Oil Project (EOP)” – has been producing oil since 1997 and current production stands at around 120,000 barrels per day (bpd). This oil is exported via Georgia and Russia through both existing and new pipelines to the Black Sea coast and then by sea, through the Turkish Straits, into the Mediterranean.

The region's existing pipelines, and alternative methods of transport, such as rail links, are now operating near the limit of their capacity, however, and this threatens to severely constrain further exports of oil and gas from Azerbaijan. Moreover, the land-locked geography of the Caspian presents considerable physical challenges in expanding the oil and gas export infrastructure. The BTC pipeline - and the related SCP gas pipeline – are intended to address these challenges and to provide the necessary export capacity that is essential for the further development of oil and gas reserves in Azerbaijan.

The BTC project is being built to transport production from the ACG oil field. The next development phase of this field (ACG Phase 1), is expected to commence production in late 2004 or early 2005, but will require additional export capacity over and above that currently being used for the EOP. Rapid build up from Phase 2 will deliver over 800,000 bpd production in 2007, and plateau production of around 1,000,000 bpd will be reached in 2010 following Phase 3 development.

The BTC pipeline has been designed to export all of the anticipated ACG oil volumes and may also be used for other Caspian Sea developments well into the future.

2.3 *Economic and social benefits*

2.3.1 Overview

The overall development of the ACG oil field including the associated BTC pipeline project will provide significant developmental benefits to the economies of Azerbaijan, Georgia and Turkey. These include the direct financial benefits of tax revenue and infrastructure investment as well as indirect benefits associated with strengthening of the countries' capabilities and institutions. It is also anticipated that there will be local benefits to the communities directly affected by the pipeline, in terms of:

- employment and procurement of local goods and services;
- enhanced recruitment and contracting practices;
- enhanced local experience and employment; and
- improvements to infrastructure and service provision.

2.3.2 Oil and gas revenues

The preliminary stage of the ACG oil field development (the Early Oil Project) has already produced over 165 million barrels of oil and delivered over \$700 million in bonus payments and profit to the State of Azerbaijan. Current forecasts indicate that, overall, the ACG project (including the BTC pipeline) has the potential to generate between \$21 and \$58 billion in income for the government of Azerbaijan over a 30 year period, and a steady stream of transit income for Azerbaijan, Georgia and Turkey.

The total government revenues related specifically to the operation of the BTC pipeline are estimated to be of the order of \$2.4 to \$3.4 billion during the period 2005 – 2024. These revenues relate primarily to transit fees that accrue on a per barrel basis. It is expected that transit revenues will be distributed between the governments of Azerbaijan, Georgia and Turkey, as summarised in Table 2.1.

Table 2.1: Forecast revenue ranges to government from the BTC project (money of the day)

Government	Anticipated revenue 2005 – 2024 (\$)
Azerbaijan*	0.6 – 0.7 billion*
Georgia	0.6 – 0.9 billion
Turkey*	1.2 – 1.8 billion*

* Note: The State Oil Company of Azerbaijan (SOCAR) will also receive \$1.8 billion profit from its 25% shareholding in the BTC project. Furthermore, BOTAŞ, the Turkish state petroleum pipeline company, will average approximately \$70 million per annum in fees for operating the Turkish section of the BTC pipeline, on top of the \$1.4 billion it receives under the LSTK for the construction of the Turkish sector of the pipeline.

2.3.2.1 *Alleviation of poverty*

The pipeline project will have a limited direct positive impact on poverty, especially during the construction period, through local employment and through payments made for labour, goods and services and land. The scale of the benefits flowing from the project will therefore largely depend on the way in which the national economies grow in response to the stimulus of project spending, and on the use made of the governments’ oil and gas revenues. Opportunities exist for investing these revenues according to the priorities set out in the Azerbaijan and Georgian governments’ poverty reduction plans and Turkey’s economic development plan. Such investment has the potential to deliver important benefits; for example, in developing critical infrastructure, fostering small and medium enterprises, and enhancing education, which in turn should contribute to a sustained reduction in poverty.

2.3.3 **Employment and procurement**

There will be some, albeit limited, employment opportunities during the construction and operation of the pipeline and its associated facilities. Current employment opportunities are extremely constrained in many of the rural areas through which the pipeline will pass, so the additional opportunities provided by the project will be an important benefit. Within the timetable, financial and technical/skills constraints, the project will maximise employment of local residents. Priority for opportunities will be given to residents of affected settlements and nationals, in preference to international expertise, where skill requirements allow.

During the construction phase, the BTC project will employ upwards of 2,000 people in each country. New employment will involve a combination of skilled workers (e.g. welders and machinery operators), semi-skilled workers (e.g. drivers, night watchmen and cooks) and unskilled labourers. A high proportion of the skilled workforce is expected to be made up of Azerbaijani, Georgian and Turkish nationals. Most semi-skilled workers are expected to be recruited from the districts and provinces near project facilities and the vast majority of unskilled labourers will come from settlements directly affected by construction activities.

Following construction, a comparatively small number of staff (around 200-300 in each country) will be required to operate the pipeline. The majority of these jobs will be for skilled technicians, engineers and operations managers. There will also be jobs created for route surveillance and other support activities.

In addition to direct employment, the BTC project will continue to create employment indirectly through procurement of goods and services from local suppliers and contractors. The project aims to address the challenge of broadening the local supplier base and proactively developing local business, through a comprehensive supplier development programme.

BP and other partners in the BTC project have already had discussions with the International Finance Corporation (IFC) to reinforce efforts to build local business capacity, so that benefits from oil and gas development activities accrue to small and medium sized enterprises (SMEs) and communities in the region. These may be linked to the IFC's Private Enterprise Partnership and SME Capacity Building Facility programmes.

2.3.4 Additional benefits

The BTC project will also bring a range of supplementary, but nevertheless important, benefits to the region. These will include:

- exposure to transparency and good governance in a major oil project;
- exposure to global management expertise and leading edge technology;
- investment in the development, training and experience of local employees;
- development of the skills of local businesses through exposure to project contracting and procurement processes;
- development of business management skills such as quality assurance and project management;
- development and enhancement of local infrastructure;
- increased knowledge of environmental and social issues through ESIA process; and
- investment in environmental protection and community development.

Further information

Further information about the economic and social aspects of the project can be found in:

- *National & Regional Review – economic, social and environmental overview of the Southern Caspian oil & gas projects*. This can be accessed via the project's website www.caspiandevlopmentandexport.com.