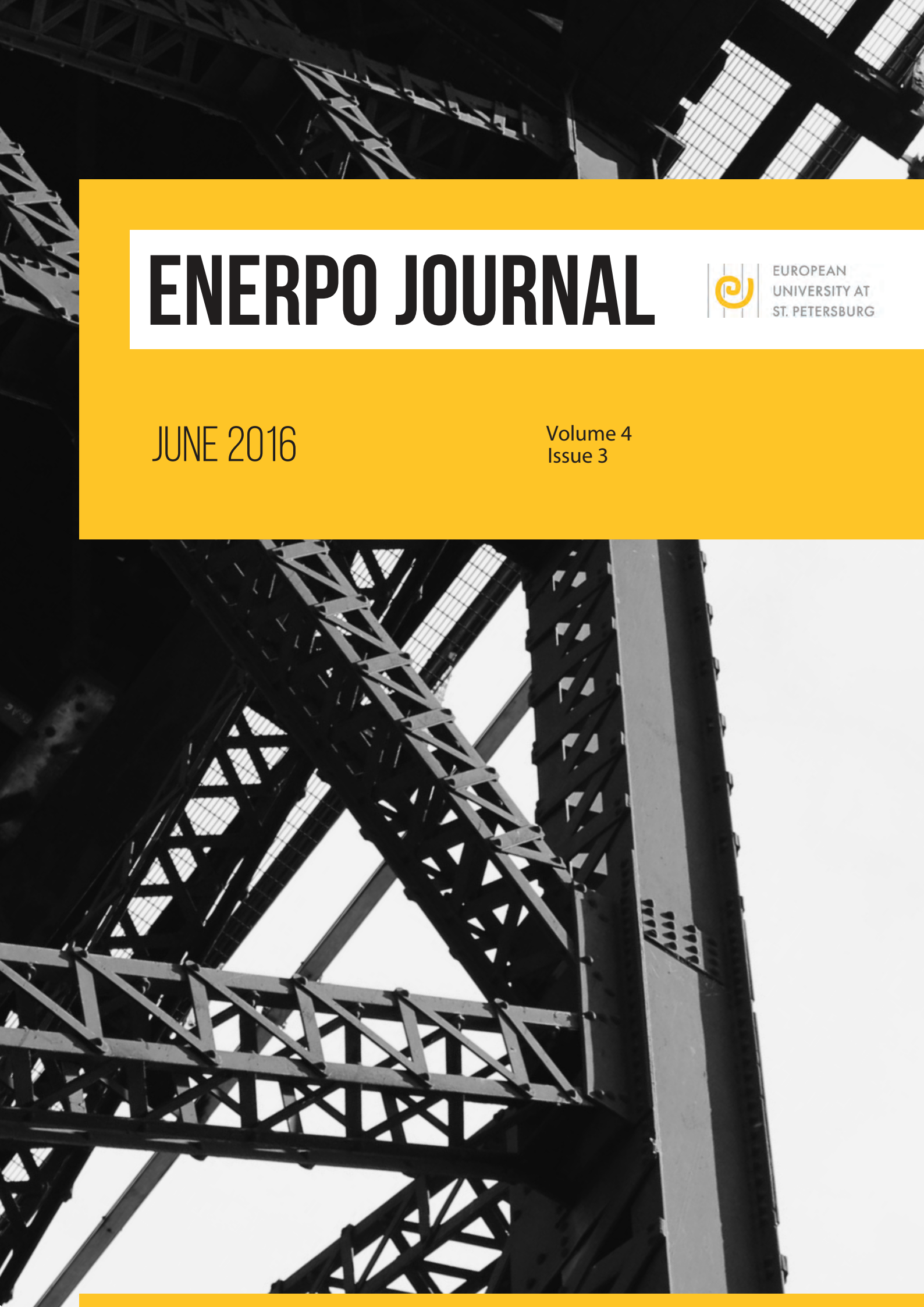

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Key words: Iran; Russia; sanctions.

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CHINA'S POSSIBLE ACCESSION TO THE ECT: BENEFITS AND OBSTACLES

Lina Strandvaag Nagell

Abstract

This paper addresses two main questions. The first asks what the benefits to China are in joining the ECT, the second whether the One Belt, One Road initiative will accelerate the country's accession to the treaty. The paper finds that the main benefits facing Chinese accession to the ECT are: (1) the increased protection of Chinese foreign investments, (2) the improvement of investor confidence in the Chinese energy market, and (3) the boost of Chinese influence in global energy governance. The main obstacles are: (1) fear of international arbitration cases against the Chinese government and (2) the scarcity of political support and geographically asymmetrical protection coverage for China. The paper also concludes that OBOR could indeed be an incentive for increased focus towards Chinese accession to the ECT and that this can again be influenced positively by a falling oil price.

Key words: OBOR; ECT; foreign investment; China.

China is facing a vastly different economic reality than has been the case since the country's opening-up policy of the 1980s.[1] A consistently high growth rate, around 9%, is expected to decline. China is thus seeking to expand to new markets, one way being through the One Belt, One Road (OBOR) initiative. The initiative includes, but is not limited to, a variety of energy projects, which are of particular interest for China as the world's largest energy consumer. There is the need to protect Chinese investments in energy projects in the over 65 countries bordering OBOR. In this regard, the relationship between China and the Energy Charter Treaty (ECT) has blossomed over the last few years and culminated in the signing of the International Energy Charter (IEC) last year. It is seen by many as a first step towards ECT accession.[2] In this paper I address two important questions:

What are the main benefits and obstacles regarding Chinese membership to the Energy Charter Treaty, and could the One Belt, One Road initiative from 2013 quicken a possible Chinese accession to the treaty?

First, I introduce OBOR, before I contextualize the renewed Chinese focus on possible ECT membership in later years, as well as the evolution of the treaty.

1 *Wang, Zhuwei, 2015. Securing Energy Flows from Central Asia to China and the Relevance of the Energy Charter Treaty to China. Energy Charter Secretariat. [online] Available at: http://www.bloomberg.com/news/articles/2016-01-20/commodities-meltdown-boosts-china-s-bid-to-build-new-silk-road [Accessed: May 30, 2016]*

2 *Zhang, Libin, 2016. China's Belt and Road Initiative and the Energy Charter Treaty. International Law Office (ILO). [online] Available at: http://www.internationallawoffice.com/Newsletters/Energy-Natural-Resources/China/Broad-Bright/Chinas-Belt-and-Road-Initiative-and-the-Energy-Charter-Treaty?redir=1 [Accessed: May 30, 2016]*

Next, I present the ECT and the core issues as they pertain to this paper. Lastly, I present the main benefits and obstacles facing Chinese ECT membership, and further explore OBOR's ability to accelerate Chinese accession to the ECT before presenting my conclusions.

THE ONE BELT, ONE ROAD INITIATIVE

The One Belt, One Road (OBOR) [figure 1][3] initiative is one of China's new tools to diversify trade routes and sustain growth rates.[4] Through OBOR, the Chinese are hoping to expand trade volumes into new markets, especially in regards to industrial materials, of which China is currently experiencing a glut. At the same time, renewed investment into China, and the new trading routes, could help alleviate Chinese dependency on foreign oil traded through Pacific ports.[4] There is also hope that the initiative could help translate China's economic dominance into geopolitical power. The initiative was formally presented by President Xi Jinping as part of formal visits to the Central Asian states,[5] but the idea has centuries-old roots in China.

3 *Nataraj, Geethanjali & Richa Sekhani, 2015. China`s One Belt One Road, An Indian Perspective. Economic & Political Weekly, Vol L, No. 49. [online] Available at: http://dev.epw.in/system/files/pdf/2015_50/49/Chinas_One_Belt_One_Road.pdf [Accessed: May 30, 2016]*

4 *Pavlicevic, Dragan, 2015. China, the EU and One Belt, One Road Strategy. The Jamestown Foundation. [online] Available at: http://www.jamestown.org/programs/chinabrief/single/?tx_ttnews%5Btt_news%5D=44235&cHash=9dbc08472c19ecd691307c4c1905eb0c#.V2sh1pMrLEa [Accessed: May 30, 2016]*

5 *Wang, Zhuwei, 2015. Securing Energy Flows from Central Asia to China and the Relevance of the Energy Charter Treaty to China. Energy Charter Secretariat. [online] Available at: http://www.bloomberg.com/news/articles/2016-01-20/commodties-meltdown-boosts-china-s-bid-to-build-new-silk-road [Accessed: May 30, 2016]*

Figure 1: China`s Proposed Silk Roads

Source: Xinhua, Council on Foreign Relations

OBOR operates with two trading routes, one maritime, and one crossing Eurasia from China to Europe.[6] Some of the major issues facing the successful implementation of OBOR are long-term cooperation with countries bordering the route, as well as the security of investments – in the energy sector in particular.[5]

China is not the first global actor to take the old traditional banner of the Silk Road, trying to modernize it, but they are the first actor to back it with considerable funding. OBOR includes a wide variety of energy projects and has indeed increased ambitions of energy contractors in the Chinese market.[7] While contractors have focused more on China-friendly markets with lower competition in the past, growing confidence among actors, particularly in the energy sector, has actors looking towards the over 65 countries that border OBOR. There will be significant challenges for these investors when facing new economic and legal environments, and, on these issues, it is important to have a certain set of rules and a clear playing field between the investors and host nations. It is in this regard that the ECT could play an important role in securing the implementation of OBOR. At the same time, increased popularity of OBOR could be thought to increase the potential of Chinese accession to the ECT.[7] The drivers of Chinese focus towards OBOR, and the possibility of falling oil prices exacerbating this focus and its potential success, will be further discussed later in this paper.

RENEWED RELEVANCE OF CHINESE ACCESSION TO THE ECT AND A CHANGING GLOBAL ENERGY LANDSCAPE

As the world's largest energy consumer, and taking into consideration China's new plans of increased investments in energy projects through OBOR, international energy cooperation is of special concern to the country. Pipelines and other energy infrastructure projects have gained positive momentum in recent years,[5] but risks regarding emergency response mechanisms, divergence in the allocation of new transit capacity along pipeline routes and investment protection in other countries, are still areas of concern. The current legal protections stipulated through existing intergovernmental agreements (IGA) and multilateral cooperative mechanisms, under the framework of the Shanghai Cooperation Organization (SCO), for example, are insufficient in ensuring the stability of energy flows for both existing and planned pipelines by a report published by the ECT in 2015, titled: *Securing Energy Flows from Central Asia to China and the Relevance of the Energy Charter Treaty to China*. Other issues concern bilateral investment treaties (BITs), in which some provisions are characterized as too conservative and less oriented towards investors.[8] Indeed, of the approximately 65 countries bordering OBOR, so far 38 have signed BITs – but some of these are limited to determine the amount of compensation in case of expropriation, and are again seen as insufficient.[9]

6 *Pavlicevic, Dragan, 2015. China, the EU and One Belt, One Road Strategy. The Jamestown Foundation. [online] Available at: http://www.jamestown.org/programs/chinabrief/single/?tx_ttnews%5Btt_news%5D=44235&cHash=9dbc08472c19ecd691307c4c1905eb0c#.V2siBJMrLEa [Accessed: May 30, 2016]*

7 *Jones, Greg, 2016. China's 'one belt, one road' policy increasing the ambitions of its energy contractors. Out-law.com. [online] Available at: http://www.out-law.com/en/articles/2016/january/chinas-one-belt-one-road-policy-increasing-the-ambitions-of-its-energy-contractors/ [Accessed: May 30, 2016]*

7 *Jones, Greg, 2016. China's 'one belt, one road' policy increasing the ambitions of its energy contractors. Out-law.com. [online] Available at: http://www.out-law.com/en/articles/2016/january/chinas-one-belt-one-road-policy-increasing-the-ambitions-of-its-energy-contractors/ [Accessed: May 30, 2016]*

8 *Wang, Zhuwei, 2015. Securing Energy Flows from Central Asia to China and the Relevance of the Energy Charter Treaty to China. Energy Charter Secretariat. [online] Available at: http://www.bloomberg.com/news/articles/2016-01-20/commodities-meltdown-boosts-china-s-bid-to-build-new-silk-road [Accessed: May 30, 2016]*

In this context, a more comprehensive multilateral legal framework, such as one presented through the ECT, could benefit China.

One of the reasons China has not yet acceded to the ECT may be based on the impression that multilateral energy organizations have been structured around the interests of powerful economies or energy-rich countries (specifically based in Europe since its infancy) – leaving smaller countries to prefer the development of relationships with major actors through bilateral cooperation.[8] In this sense, there has not been a great need for China to accede to the ECT, as it was originally outside of the initial scope of the treaty, and smaller nations working together with China may not have seen its interests best served through the ECT, opting for BITs with energy giant China instead. The ECT's geographic focus on Europe in its infancy now appears to be changing through the IEC. A new era dominated by globalization, increased competition, and technological advances may have changed the needs for multiple global actors. In facing these new challenges, multilateral energy diplomacy is stated as having become more policy-focused and practical.[8] The changing landscape alongside an increased willingness from international organizations to grow their member base, again exemplified by the ECT's renewed efforts through the IEC,[10] is leading smaller potential member states to believe that certain adjustments better incorporate newcomers.

THE ENERGY CHARTER TREATY

The ECT was signed in 1994, entering into force in 1998.[11] It builds on the 1991 Energy Charter (EC) – also known as the European Energy Charter.[12] The EC is an expression of the foundations which should underlie international energy cooperation. Developed in the period following the Cold War, the EC and ECT exist to establish commonly accepted foundations for energy cooperation amongst states.[12] China gained observer status to the ECT in 2001 and signed the International Energy Charter (IEC) in 2015. The IEC differs from the ECT in that it is a declaration of political intention, aiming at strengthening energy cooperation between the signatory states. While the ECT is legally binding, the IEC is not. The IEC may be considered a mechanism for expanding the ECT internationally, whereas the main goal of the ECT is to strengthen the rule of law on energy issues.[13]

Provisions within the ECT regarding foreign investments are considered a cornerstone of the treaty. The goal is to create a level playing field for investments made in the energy sector. Investments in the energy sector have a tendency to span long time periods and demand large investments. In this regard, it can take time before investors see a return on their investment. When an investment in a host nation is made, the risk of obsolescing bargaining can also run deep. Obsolescing bargaining[14] is the issue of risk allocating rapidly from the capital-hungry host state to the investor, once the initial investment (in energy projects often being the bulk of the investment) is made.[13] Uncertainties in this regard lead to lack of confidence in the host nation's market and deter future investments. It is important to note that the ECT does not create investment opportunities, but provides stable interface between the investor and the host nation.[15]

One potential issue for new members to the ECT is the level of change thrust upon potential new members when acceding to the treaty. It is true that the ECT does not seek to determine the structure of national energy markets, dictate national energy policies or oblige member states to open up their energy sector to foreign investors,[16] but at the same time member states are liable for suits posed by foreign investors in the energy market.[17] This is something that could prove to be a difficult pill for the Chinese government to swallow. In this regard, a well-known part of the ECT, especially important when discussing possible Chinese membership, is the investor-contracting party dispute mechanism (Article 26). Under this article, it is stated that a contracting party: "shall give unconditional consent to the submission of a dispute from an investor of another contracting party to international arbitration."[15]

The ECT faces serious challenges; the most important of the is the fragmentation of global energy governance. This could be a reason behind ECT's renewed focus. With an original geographic background in Europe, the ECT has traditionally enjoyed backing from the EU. However, this has changed along with the establishment of other external policy instruments, such as the European Community Treaty. The decision of Russia to withdraw from the treaty in 2009 also had a damaging effect on the role played by the ECT in global energy governance.[15] The advantage of the ECT is that it covers the entire value chain of the energy industry with multilaterally and legally binding obligations.[17]

9 *Zhang, Libin, 2016. China's Belt and Road Initiative and the Energy Charter Treaty. International Law Office (ILO). [online] Available at: http://www.internationallawoffice.com/Newsletters/Energy-Natural-Resources/China/Broad-Bright/Chinas-Belt-and-Road-Initiative-and-the-Energy-Charter-Treaty?redir=1 [Accessed: May 30, 2016]*

10 *Zhang, Libin, 2016. China's Belt and Road Initiative and the Energy Charter Treaty. International Law Office (ILO). [online] Available at: http://www.internationallawoffice.com/Newsletters/Energy-Natural-Resources/China/Broad-Bright/Chinas-Belt-and-Road-Initiative-and-the-Energy-Charter-Treaty?redir=1 [Accessed: May 30, 2016]*

11 *Selivanova, Yulia, 2012. The Energy Charter and the International Energy Governance. European Yearbook of International Economic Law (EYIEL), Vol. 3.*

12 *Energy Charter Treaty, 2016. Investment. [online] Available at: http://www.energycharter.org/what-we-do/investment/overview/ [Accessed: May 30, 2016]*

13 *Wang, Zhuwei, 2015. Securing Energy Flows from Central Asia to China and the Relevance of the Energy Charter Treaty to China. Energy Charter Secretariat. [online] Available at: http://www.bloomberg.com/news/articles/2016-01-20/commodities-meltdown-boosts-china-s-bid-to-build-new-silk-road [Accessed: May 30, 2016]*

14 *Martin, Timothy A. Dispute Resolution in the International Energy Sector: an overview. Journal of World Energy Law and Business, 2011, Vol. 4, No. 4.*

15 *Wang, Zhuwei, 2015. Securing Energy Flows from Central Asia to China and the Relevance of the Energy Charter Treaty to China. Energy Charter Secretariat. [online] Available at: http://www.bloomberg.com/news/articles/2016-01-20/commodities-meltdown-boosts-china-s-bid-to-build-new-silk-road [Accessed: May 30, 2016]*

16 *Energy Charter Treaty, 2016. Investment. [online] Available at: http://www.energycharter.org/what-we-do/investment/overview/ [Accessed: May 30, 2016]*

BENEFITS OF CHINESE ACCESSION TO THE ECT

Increased Protection of Chinese Foreign Investments

The renewed Chinese focus and investment made in energy infrastructure abroad is an important factor. These renewed efforts have left some of the host nations to question Chinese motives,[18] one Chinese fear being that Chinese investments in strategically important industries could lead to political interference by host nations. In this regard, accession to the ECT is mentioned as a way to protect foreign Chinese investments. Other fears are investments being blocked by unfair or discriminatory practices under an argument of matters of national security, as well as other political and economic considerations from the host countries. Here, as mentioned previously, the shortcomings of existing BITs are of particular concern.[18] Indeed, BITs with several Central Asian countries are not legally binding, but all of these countries are signatories to the ECT.[19]

Improvement of Investor's Confidence in the Chinese Energy Market

Within China, the ECT could also have a beneficial role to play. The dominant part played by state-owned enterprises (SOEs) in the Chinese energy industry, alongside a scarcity of sufficient legal protection for foreign investments in China, is a concern and could dampen foreign investments in the Chinese energy market. In this regard, accession to the ECT could help improve China's reputation as an investment destination. In light of increasing energy demand, the Chinese energy market is continuously being opened up to foreign investments in order to modernize and introduce new technology.[18] There are many obligations and responsibilities for potential members stipulated in the ECT and, in this regard, Chinese accession to the ECT would promote the optimization of the domestic legal environment and help increase investor confidence.[18]

As mentioned, the ECT may leave the member state in question quite free to determine the system of property ownership of its national energy resource, while at the same time opening it up to suits from new investors.[20] In this regard, there is a good chance that the Chinese government will think twice before acceding to the ECT. Taking into consideration that a relatively new government, led by President Xi Jinping, is believed to further consolidate its power at the National Congress of the Communist Party set for 2017,[21] this might not be the time for opening up the Chinese economy further - politically. At the same time, the sitting government is increasingly concerned about diminishing growth rates, something that could be alleviated somewhat with increased investments resulting from accession to the ECT. Indeed, it is suggested by Wang that, "with Chinese accession to the ECT, it is reasonable to believe that more foreign energy investment with outstanding expertise will flow into the Chinese domestic energy industry and, more importantly, will make a certain contribution to the sustainable development of the Chinese economy and society in the long run."[22]

Boost of Chinese influence in global energy governance

As the global energy landscape is being transformed due in part to increasing demand from BRICS countries and increased efforts to reduce carbon emissions from, amongst others, developing nations as well as developed nations, it is argued by Wang that China will play an increasing role in global energy dominance, as the largest developing country in the world.[22] The ECT offers one way for China to fulfill its deeper involvement in global energy governance. China would, if acceding to the ECT, be in a position where it could communicate and cooperate[22] with all member states of the ECT, an advantage when seeking a leading role. China would also be able to influence the framework of the ECT to a greater extent as a full-fledged member.

OBSTACLES FACING CHINESE ACCESSION TO THE ECT

Fear of international arbitration cases against the Chinese government

There is still a great deal of support within the Chinese government to characterize the energy industry as important to national security and social stability, as is to be expected. This idea stands in the way of the promotion of reform and liberalization of the economy.[23] The road to a fully competitive energy market in China is partly blocked by this fear. Bearing in mind Article 26 of the ECT, a major concern is that utilization of this clause will impose

17 Zhang, Libin, 2016. China's Belt and Road Initiative and the Energy Charter Treaty. International Law Office (ILO). [online] Available at: http://www.internationallawoffice.com/Newsletters/Energy-Natural-Resources/China/Broad-Bright/Chinas-Belt-and-Road-Initiative-and-the-Energy-Charter-Treaty?redir=1 [Accessed: May 30, 2016]

18 Wang, Zhuwei, 2015. Securing Energy Flows from Central Asia to China and the Relevance of the Energy Charter Treaty to China. Energy Charter Secretariat. [online] Available at: http://www.bloomberg.com/news/articles/2016-01-20/commodities-meltdown-boosts-china-s-bid-to-build-new-silk-road [Accessed: May 30, 2016]

19 Zhang, Libin, 2016. China's Belt and Road Initiative and the Energy Charter Treaty. International Law Office (ILO). Available at: http://www.internationallawoffice.com/Newsletters/Energy-Natural-Resources/China/Broad-Bright/Chinas-Belt-and-Road-Initiative-and-the-Energy-Charter-Treaty?redir=1 [Accessed: May 30, 2016]

20 Energy Charter Treaty, 2016. Investment. [online] Available at: http://www.energycharter.org/what-we-do/investment/overview/ [Accessed: May 30, 2016]

21 The Manila Times, 2016. Stratfor analysis, China: Raising the stakes in Xi's consolidation of power. The Manila Times. [online] Available at: http://www.manilatimes.net/china-raising-the-stakes-in-xis-consolidation-of-power/246774/ [Accessed: May 30, 2016]

22 Wang, Zhuwei, 2015. Securing Energy Flows from Central Asia to China and the Relevance of the Energy Charter Treaty to China. Energy Charter Secretariat. [online] Available at: http://www.bloomberg.com/news/articles/2016-01-20/commodities-meltdown-boosts-china-s-bid-to-build-new-silk-road [Accessed: May 30, 2016]

23 Wang, Zhuwei, 2015. Securing Energy Flows from Central Asia to China and the Relevance of the Energy Charter Treaty to China. Energy Charter Secretariat. [online] Available at: http://www.bloomberg.com/news/articles/2016-01-20/commodities-meltdown-boosts-china-s-bid-to-build-new-silk-road [Accessed: May 30, 2016]

arbitration burdens on the Chinese government. Libin Zhang states that the benefits of a Chinese accession to the ECT outweigh the costs, but it is important to note that the Chinese government's main objective may not be purely economic – it also needs to continue its hold on power, something which could be challenged through these suits.[24] It is also noted by Wang that lack of experience and knowledge surrounding international arbitration procedures within the ECT is something that must be rectified before any Chinese accession to the ECT.[24]

Scarcity of political support and geographically asymmetrical protection coverage for China

The ECT's role in global energy governance has changed since its initiation, something that might be one of the contributing factors to its renewed international focus. Despite the aforementioned advantages of the ECT, there is a concern that the focus on legal aspects of the energy value chain might be too wide to be addressed by the ECT,[23] the fear being that too wide a focus will lead to a decline in political attachment to the ECT. Geographically asymmetrical protection coverage and Chinese cooperation with certain countries not party to the ECT counter Chinese cooperation with countries which are members of the ECT and are by some seen as an obstacle. Other observers, however, note that the international scope of the IEC and ECT might see these issues resolve themselves in the near future.[23]

OBOR – AN INCENTIVE FOR CHINESE ECT ACCESSION?

OBOR could work as an incentive for Chinese accession to the ECT. An interesting point, however is that OBOR has tended to fluctuate in importance for the Chinese government, at times being little more than a loose set of ideas not being comprehensibly implemented. The fall of the oil price does have the potential to increase the importance and probability of OBOR being successfully implemented and possibly refocus China towards the ECT.[25] As many of the countries along the OBOR route are highly dependent on the trading of natural resources, these countries could struggle under falling oil prices and might be more inclined to accept Chinese investment pitches, as well as to taking a share in China's $40 billion (US) Silk Road Infrastructure Fund. This situation could increase willingness from both the Chinese government and potential trading partners to focus on OBOR and subsequently incentivize Chinese accession to the ECT.[25]

CONCLUSIONS

What are the main benefits and obstacles regarding Chinese membership to the Energy Charter Treaty, and could the One Belt, One Road initiative from 2013 accelerate a possible Chinese accession to the treaty?

It is my conclusion that the main benefits facing Chinese accession to the ECT are:

1. Increased protection of Chinese foreign investments
2. Improvement of investor confidence in the Chinese energy market
3. A boost of Chinese influence in global energy governance

The main obstacles are:

1. Fear of international arbitration cases against the Chinese government
2. The scarcity of political support and geographically asymmetrical protection coverage for China

I also conclude that OBOR could indeed be an incentive for increased focus towards Chinese accession to the ECT and that this can again be influenced positively by a falling oil price.

Lina Nagell

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24 Zhang, Libin, 2016. China's Belt and Road Initiative and the Energy Charter Treaty. International Law Office (ILO). [online] Available at: http://www.internationallawoffice.com/Newsletters/Energy-Natural-Resources/China/Broad-Bright/Chinas-Belt-and-Road-Initiative-and-the-Energy-Charter-Treaty?redir=1 [Accessed: May 30, 2016]

25 Shi, Ting, 2016. Commodities Crash Boosts China's New Silk Road. Bloomberg Business. [online] Available at: http://www.bloomberg.com/news/articles/2016-01-20/commodities-meltdown-boosts-china-s-bid-to-build-new-silk-road [Accessed: May 30, 2016]

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PRODUCTION SHARING AGREEMENTS (PSAs): AZERBAIJAN'S PRACTICE

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Abstract

This article discusses the main concepts of Azerbaijan's production sharing agreements (PSAs), which regulate the legal, commercial, and fiscal relationships between the government of Azerbaijan and international oil companies (IOCs). It explores the reasons behind Azerbaijan's preference of this type of contractual arrangement, the historical setup for PSA contracts within the country, and their economic peculiarities and anomalies from a legal perspective. It also touches on some dark Azerbaijani PSAs and implications that appear during the implementation of PSA contracts and points out problem areas needing reform.

Key words: Azerbaijan; product sharing agreements; exploration and production; oil; natural gas.

After the collapse of the Soviet Union in 1991, a new set of oil- and gas-producing countries emerged in the Caspian basin, including Azerbaijan. Hydrocarbon resources of Caspian countries have become a key force for attracting huge amounts of foreign investment and a leading mechanism for their political and economic development. The dominant contractual form for exploiting and developing oil and gas fields in these countries, including Azerbaijan, has been production sharing agreements (PSAs).[1]

During the 1990s, newly established littoral states in the Caspian Sea region lacked not only the capital, but also the necessary technical expertise and skilled labor, to efficiently exploit their natural resources. Their economies were weak; transition from a centrally planned economy to capitalism and economic crises after the dissolution of the Soviet Union made it hard to afford the modern infrastructure necessary for the realization of new oil and gas projects. All these factors made them unable to apply types of production contracts other than PSAs that could be more beneficial to them as host countries.[2]

An involvement of foreign capital and expertise is only necessary in the exploration and exploitation stages (once production starts, foreign companies become more expendable). In the meantime, IOCs also need to recoup their costs and ensure profit from the projects in which they make investments. PSA contracts are typically structured to reflect this time inconsistency issue.[3] Most energy PSAs cover long-life projects and if any amendments to a contract are suggested by a host country, they will be challenged under arbitration and risk the loss of future investments.[4] Host countries also need to prove their reliability if they are looking for further foreign investment or future loans from international financial organizations and banks.

As for Azerbaijan, despite many worries about the possible shift of leverage and the global economic recession, windfall revenues from high oil prices in the 2000s did not lead to an imbalance between the host country and international oil companies. Azerbaijan has never attempted to revise or change its oil policies or nationalized/quasi-nationalized oil assets (mainly because of its strong economic and political interests in maintaining the presence of Western oil companies in the country).[5] Only recently, the country proposed to renew a contract on Azeri-Chirag-Guneshli offshore oil fields, with consent of foreign partners. Before discussing specific issues about the Azerbaijani PSAs and their nature, let us have a closer look at the major deals that Azerbaijan concluded and compare them to other types of contractual arrangements used for exploration and development of oil and gas fields.

HISTORY OF AZERBAIJAN'S OIL AND GAS CONTRACTS

In the early 1900s, Azerbaijan was the center of the world,

1 *Pomfret, R. Exploiting Energy and Mineral Resources in Central Asia, Azerbaijan and Mongolia. July 2010, p. 5.*

2 *Pomfret, R. Resource Management and Transition in Central Asia, Azerbaijan and Mongolia. March 2011, pp. 7-8.*

3 *Ibid.*

4 *Ibid.*

5 *Gojayev, V. Resource Nationalism Trends in Azerbaijan 2004-2009. RUSSCASP, March 2010, p. 3.*

producing half of the world's output. However, in the second half of the twentieth century, the situation changed and oil production in Baku stagnated as Soviet oil investment focused on Siberia.[6]

Liberalization and perestroika in the 1980s USSR created certain opportunities for foreign investment, especially in the natural resources of the Soviet Union. This attracted the attention of transnational oil companies. After a break of 70 years, representatives of foreign firms began visiting oil-rich regions of the Soviet Union, including Azerbaijan.[7]

In Azerbaijan, the Chirag and Azeri deposits, discovered in 1985-87, and the existence of already-developed oil-industry infrastructure caught the interest of foreign companies. In January 1991, the Soviet government announced a tender on Azerbaijani deposits, as a great amount of investment and new technologies were needed to explore fields located in the depths of the Caspian Sea. An American company, Amoco, won this tender, but the Azerbaijani government decided to bring other companies in line as well (Unocal, BP/Statoil, McDermott and Ramco) and to create a consortium that would carry out technical feasibility studies and prepare draft contracts.[8]

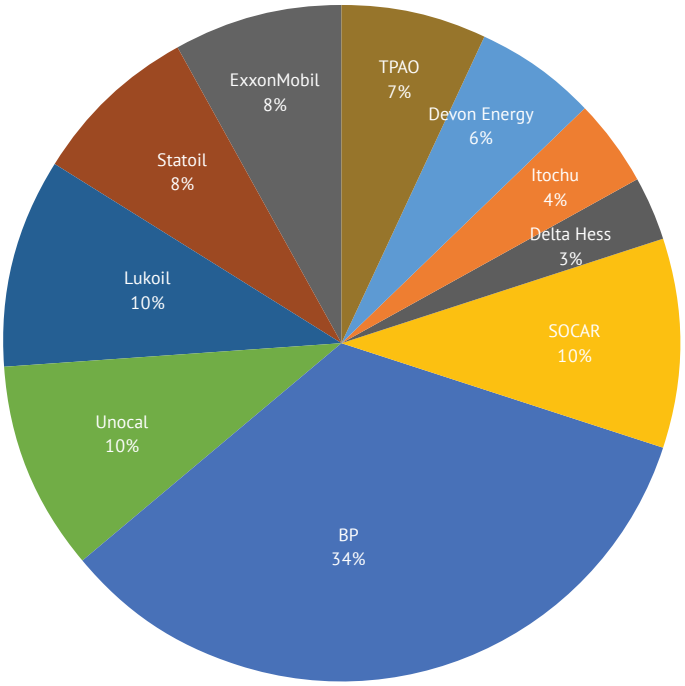

Figure 1: Interest share of companies upon conclusion of the Contract of the Century

Source: Bagirov S. 2007

After Azerbaijan gained independence, the new government continued negotiations with foreign companies on the joint exploration of oil fields, but power changes in May 1992 and June 1993 delayed the negotiation process. Finally, on September 20, 1994, Azerbaijan signed its long-awaited "Contract of the Century" with a consortium of foreign oil companies, creating the Azerbaijan International Operation Company (AIOC). The consortium was focused on the joint development of the deepwater portion of the merged Azeri, Chirag and Guneshli (ACG) deposits.[9] The consortium of foreign oil companies, which consisted of BP, Amoco, McDermott, Pennzoil, Exxon, Statoil, Ramco, TPAO, and Lukoil, committed to invest $7.4 billion in these three major offshore oil fields over thirty years. Upon ratification, the Azerbaijani Parliament received a $150 million payment, with a further $500 million signing bonus to be paid on ratification and agreement of a pipeline route.[10] The National Oil Strategy was articulated with the following components: technology provided by foreign oil companies, multiple transport routes, accumulation of managerial expertise, and investment in sustainable development.[11]

Nevertheless, new shareholders replaced some of the initial participants of the project over time. Currently, shares of the ACG project participants are as follows: BP – 35.8 percent; SOCAR – 11.6 percent; Chevron – 11.3 percent; INPEX – 11 percent; Statoil - 8.6 percent; ExxonMobil – 8 percent; TPAO – 6.8; percent, Itochu – 4.3 percent; and ONGC – 2.7 percent.[12]

Although the negotiations for developing the given fields were started long before contracts were signed, only the current government of Azerbaijan was able to bring them to fruition and reap the revenues.

Despite Russian objections, political instability within the country, and the conflict with neighboring Armenia over the Nagorno-Karabakh, the signing of oil and gas contracts continued.[13]

In the 2000s, huge investments were made by foreign firms to develop new Azerbaijani gas fields: SOCAR and BP signed a gas PSA in July 2010 for the development of the Shafag and Asiman fields. SOCAR, Total and Gaz de France signed a PSA in 2009 for the development of Absheron field, and a PSA for the Shah Deniz field, the largest gas field in Azerbaijan and the 9th largest in the world (with reserves of about 1.2 tcm), was signed by a consortium of companies, composed of lead operator BP, Statoil, SOCAR, Lukoil, Total, NICO, and TPAO.[14]

The creation of huge pipeline projects westward, that avoided Russia as a transit country (such as the Baku-Tbilisi-Ceyhan Pipeline and South Caucasus Pipeline –

7 *Bagirov, S. Azerbaijan's Oil Revenues: Ways of Reducing the Risk of Ineffective Use. Jan 2007, p. 20.*

8 *Ibid. pp. 20-21.*

9 *Ibid. pp. 21-23.*

10 *Pomfret, R. Exploiting Energy and Mineral Resources in Central Asia, Azerbaijan and Mongolia. July 2010, p. 6.*

11 *Ibid.*

12 *BP Azerbaijan [Online]. Available at: http://www.bp.com/en_az/caspian/operationsprojects/ACG.html [Accessed: May 30, 2016]*

13 *Gojayev, V. Resource Nationalism Trends in Azerbaijan 2004-2009. RUSSCASP, March 2010, pp. 3-8.*

14 *Ciaretta, A. and S. Nasirov. Development Trends in the Azerbaijan Oil and Gas Sector: Achievements and Challenges. Energy Policy, 2011, Vol. 40, p. 286.*

Figure 2. Baku-Tbilisi-Ceyhan Pipeline Source: SOCAR AZERBAIJAN - SOCAR ROMANIA

See Figure 2), enabled Azerbaijan to decrease its traditional dependence on its powerful northern neighbor and to reinforce its independence, further promoting its geopolitical interests by converting its energy resources into a diplomatic tool.[15]

HOW DO PSAs DIFFER FROM OTHER TYPES OF OIL AND GAS CONTRACTS?

There are four basic types of contractual arrangements commonly used for oil and gas exploration and development: concessions, production sharing agreements, service contracts, and joint ventures. The difference between them lies in the level of control given to foreign contractors over operations and production, the level of government involvement, and the share of the revenue between foreign contractors and the government.[16]

Concessions were the first type of oil contracts put in use and have different names depending on a country's legislation; such as "permission," "license," or "rent". In concessions, the company extracting hydrocarbon reserves in the territory of the host country owns the extracted resources.

In comparison, PSAs give more power to the host government over controlling the extraction of hydrocarbon reserves.[17] However, how the host government chooses to exploit its energy resources (public and private ownership, state control, or lack of control) is also a crucial determinant.[18] Even the same type of agreements may differ from contract to contract, depending on the contractual terms agreed between host state and foreign firms. Taxonomy provided by some researchers[19] shows that the outcome in Russia (licenses with domestic private ownership) and in Uzbekistan and Turkmenistan (PSAs with state ownership and control) is superior to that in Azerbaijan (PSAs with state ownership and foreign operational control), and Kazakhstan (PSAs with foreign private ownership) is worst of all.

The first PSAs were introduced in Indonesia in 1966 and then spread globally to all oil-producing regions, with the exception of Western Europe.[20] PSAs are distinguished from other types of contracts in two ways: first, the foreign firm or contractor provides all technical and financial services for exploration and development operations and bears the entire exploration risk. If no oil is found, the firm receives no compensation. Second, the host government owns both the resource and installations provided the by foreign company and bears no risk. It shares potential profit without having to make a direct investment.[21] PSAs have changed over time and taken different forms in different host countries.

15 Gojayev, V. Resource Nationalism Trends in Azerbaijan 2004-2009. RUSSCASP, March 2010, pp. 3-8.

16 Ciaretta, A. and S. Nasirov. Development Trends in the Azerbaijan Oil and Gas Sector: Achievements and Challenges. Energy Policy, 2011, Vol. 40, p. 287.

17 Bagirov, S. Azerbaijan's Oil Revenues: Ways of Reducing the Risk of Ineffective Use. Jan 2007, p. 25.

18 Pomfret, R. Exploiting Energy and Mineral Resources in Central Asia, Azerbaijan and Mongolia. July 2010, p. 17.

19 Luong, J. and Weinthal. Rethinking the Resource Curse: Ownership structure, institutional capacity, and domestic constraints. Annual Review of Political Sciences, 2006, Vol. 9, pp. 241-63.

20 Bindemann, K. Production Sharing Agreements: An Economic Analysis. OIES WPM, October 1999, Vol. 25, p. 1.

21 Ciaretta, A. and S. Nasirov. Development Trends in the Azerbaijan Oil and Gas Sector: Achievements and Challenges. Energy Policy, 2011, Vol. 40, p. 288.

PSAs usually have the following properties:

- The foreign contractor pays a royalty on gross production to the government
- After the royalty is deducted, the contractor takes a pre-specified share of production for cost recovery
- The remainder of the production, referred to as "profit oil", is shared between the host government and the contractor at a stipulated rate
- The contractor has to pay taxes on its share[22]

Cost recovery is the most attractive component of PSAs since concessions do not offer recovery for sunk costs.

Nevertheless, PSA contracts contain some drawbacks as well. There is an asymmetric information issue during the negotiations process in which the operating firms have a better idea of the magnitude of the upfront costs and may overstate these in negotiations so that they recoup more money before the state starts to take a larger share of the revenues. Moreover, if the state fails to specify environmental and work safety obligations or other responsibilities related to the negative externalities in the contract, then the contracting party may not be obliged to spend money on these issues. Sometimes, the state negotiators may even be aware of such discrepancies in the contract, but may turn a blind eye and sign off on the contract for a bribe.[23]

Disagreements over contracts often lead to demands for renegotiation, resulting from the increase in profitability of the natural resource, issues related to the taxation of the foreign firm, or issues related to the cost recovery and split of revenues between firm and host government.[24] This is especially true when oil prices are high. In practice, however, the actions of the state are severely constrained for renegotiation by contractual terms and the risk of losing future FDI. It is better to establish contract provisions in order to determine when or in which cases terms on cost recovery can be renegotiated.[25]

In addition, the profit splits between foreign firms and nations depend on the involvement of domestic companies; if domestic companies are part of the exploiting consortium, then more revenues accrue domestically.[26]

Another type of contractual arrangement for oil and gas exploration and development is the joint venture (JV), which originated in the United States - a model proposed by the American Association of Petroleum Landmen. In JVs, an operator takes sole control of the exploration and exploitation operations supervised by an operating committee that is composed of co-venturers who have votes in proportion to their stakes. Under JVs, the host government and foreign operating company have direct ownership of the project (including equipment and facilities) for oil and gas production. During the 1990s, the Azerbaijani government replaced JVs with PSAs due to the economic crises, a lack of modern infrastructure, and considerable need for foreign funding to exploit its hydrocarbon reserves.[27]

SPECIFIC FEATURES OF AZERBAIJANI PSAs

Azerbaijan is represented by the State Oil Company of Azerbaijan Republic (SOCAR) in domestic PSA contracts. Initially, SOCAR had a minority stake in all operational Azerbaijani PSAs,[28] but since the signing of the "Contract of the Century," SOCAR signed more than 30 PSAs with AIOC.[29] Now, let us look at specifics of PSA contracts signed by Azerbaijan.

Except for the Contract of the Century, all Azerbaijani PSAs on deposits in the Caspian Sea agree on three terms: the period of exploration (about three years), the additional period of exploration (ranges from one to three years), and the period of development and extraction (is 25 years for most contracts). Only three contracts have different extraction periods: Azeri-Chirag-Guneshli and Shah Daniz deposits – 30 years, and Nakhchivan deposit – 35 years. However, the parties can extend the term of the contract if they are interested or new reserves are discovered in the contractual area. During the exploration period, the contractor makes annual per-acre payments to the Azerbaijani government.[30]

In accordance to the PSAs, Azerbaijan owns all the resources and installations, but, unlike PSAs in other countries, the foreign contractor does not pay royalties to Azerbaijan, but does pay tax on profits, between 25 and 32 percent. Azerbaijani PSAs have the following features: "*(1) Operator recovers its costs at a pre-specified percentage of gross production; (2) after cost recovery, profits are distributed between the contract partners as per the PSA; (3) most*

22 Bindemann, K. Production Sharing Agreements: An Economic Analysis. OIES WPM, October 1999, Vol. 25, p. 1.

23 Pomfret, R. Exploiting Energy and Mineral Resources in Central Asia, Azerbaijan and Mongolia July 2010, p. 15.

24 Bindemann, K. Production Sharing Agreements: An Economic Analysis. OIES WPM, October 2009, Vol. 25, p. 5.

25 Ciaretta, A. and S. Nasirov. Development Trends in the Azerbaijan Oil and Gas Sector: Achievements and Challenges. Energy Policy, 2011, Vol. 40, p. 288.

26 Pomfret, R. Exploiting Energy and Mineral Resources in Central Asia, Azerbaijan and Mongolia. July 2010, p. 15.

27 Ciaretta, A. and S. Nasirov. Development Trends in the Azerbaijan Oil and Gas Sector: Achievements and Challenges. Energy Policy, 2011, Vol. 40, p. 287.

28 Pomfret, R. Exploiting Energy and Mineral Resources in Central Asia, Azerbaijan and Mongolia. July 2010, p. 7.

29 Ciaretta, A. and S. Nasirov. Development Trends in the Azerbaijan Oil and Gas Sector: Achievements and Challenges. Energy Policy, 2011, Vol. 40, p. 288.

30 Bagirov, S. Azerbaijan's Oil Revenues: Ways of Reducing the Risk of Ineffective Use. Jan 2007, p. 26.

PSAs also involve substantial bonus payments; (4) with regard to new capital, a PSA is a flexible agreement whereby if the Azerbaijani and international partners mutually agree, a new participant can enter the PSA; (5) the PSA provides investors with protection against changes in legislation".[31]

The fiscal system of Azerbaijani PSAs is structurally based on the principle of profitability responsive to costs and recovery of investments, oil price changes, production profile, timing of payments, and contractual stability.[32]

Cost recovery in Azerbaijani PSAs includes operational (current expenses for purchase of materials, fixed, and other operational expenses) and capital expenses (drilling expenses, expenses for equipment, platforms purchased, and pipeline). The cost oil (a portion of produced oil taken on an annual basis by the operator to recoup its exploitation expenses) available to cover operating costs is 100 percent. Additionally, it is necessary to know the price of oil to calculate what percentage of oil will go to cover those expenses. Capital costs must be recovered from no more than 50 percent of the remaining total production after operational expenses are taken. After operational and capital expenses are deducted from gross production, the remaining part of the so-called profit oil is then divided between SOCAR (state share) and the foreign contractor. Profit oil is calculated according to the real rate of return (adjustments resulting from inflation and other external factors) and the R-factor (ratio of the revenue to the expenses) in Azerbaijan.[33] All calculations are made on a quarterly basis.[34]

In Azerbaijani PSAs, the extracted oil is divided amongst partners before it is placed on the market in the territory of Azerbaijan (i.e. the extracted oil is split at the points of delivery shown on the contracts).[35] A standard PSA grants the contractor the right to freely sell or market the produced oil and gas.[36]

In recent years, SOCAR's share of revenues from PSAs has been increasing compared to the times when contracts were signed, as most of the cost recovery payments have already been made to investors.

In addition, bonuses have been another source of revenue for the state. PSAs usually contain signing bonuses (paid when the contract is signed), production bonuses (paid upon attaining a certain level of production), and discovery bonuses (paid on initial discovery).[37]

All Azerbaijani PSAs include broad stabilization clauses that couple freezing with economic balancing. The Azerbaijani government bars the application of an adverse change in laws to investment contracts. In cases where amendments to laws cause deterioration of the conditions for investment, the laws that existed when the investment was made continue to be applied for 10 years.[38]

In all standard PSAs, Azerbaijan offers innovative mechanisms for the decommissioning of oil and gas installations and other fixed assets (like platforms, pipelines, wells, gathering facilities, jackets, etc.) through jointly opened escrow accounts at an internationally reputable bank – the so called "Abandonment Fund." It envisages the transfer of the fixed and movable petroleum assets to SOCAR following the contractor's recovery of cost or termination of the contract, whichever is earlier.[39]

The indemnification clauses in Azerbaijani PSAs – meant for the case of expropriation of the contractor's rights, interests, or property by the government – are also more broad than international standards. This is why future PSAs needs to reflect more reasonable compensation standards under international law, as well as forego underdeveloped reserves where a contractor has made no investment.[40]

Regarding taxation, each PSA has its own separate tax regime.[41] The contractor has to pay only the taxes outlined by the contract. Foreign oil and gas companies pay taxes via SOCAR. In other words, they do not have any direct contact with state tax authorities. Tax revenues are transferred to the Ministry of Taxes of Azerbaijan by SOCAR. The tax rate depends on the share of the foreign companies in the contract: 32 percent income tax for a share greater than 30 percent. If profits are reinvested, they are exempted from taxes.[42] However, unlike those of most petroleum-producing countries, the PSA regime of Azerbaijan does not envisage a withholding tax on dividends or repatriation of profits sourced from Azerbaijan, and it disincentivizes IOCs to reinvest their profits. Introduction of such a tax in future PSAs may induce reinvestment of IOCs' profits and boost a more efficient fiscal regime for contracts.[43]

31 Ciaretta, A. and S. Nasirov. Development Trends in the Azerbaijan Oil and Gas Sector: Achievements and Challenges. Energy Policy, 2011, Vol. 40, p. 288.

32 Mustafayev, N. Production-sharing agreements in the petroleum industry of Azerbaijan. Journal of World Energy Law and Business, 2015, Vol. 8, No. 4, p. 372.

33 Ciaretta, A. and S. Nasirov. Development Trends in the Azerbaijan Oil and Gas Sector: Achievements and Challenges. Energy Policy, 2011, Vol. 40, pp. 288-289.

34 Bagirov, S. Azerbaijan's Oil Revenues: Ways of Reducing the Risk of Ineffective Use. Jan 2007, p. 28.

35 Ibid p.38

36 Mustafayev, N. Production-sharing agreements in the petroleum industry of Azerbaijan. Journal of World Energy Law and Business, 2015, Vol. 8, No. 4, p. 371.

37 Ibid. p.289.

38 Ibid.

39 Ibid.

40 Ibid.

41 Ibid.

42 Ciaretta, A. and S. Nasirov. Development Trends in the Azerbaijan Oil and Gas Sector: Achievements and Challenges. Energy Policy, 2011, Vol. 40, p. 289.

43 Mustafayev, N. Production-sharing agreements in the petroleum industry of Azerbaijan. Journal of World Energy Law and Business, 2015, Vol. 8, No. 4, p. 374.

Yet the advantages of Azerbaijani PSA agreements are not limited by the above-mentioned ones. All Azerbaijani PSAs have import and export duty exemptions, no custom duty is applied, and there is a zero VAT system.[44]

In accordance with Azerbaijani PSAs, contractors are required to submit annual work programs, together with relevant budgets, for the approval of the Steering Committee before the beginning of each calendar year. In the case of failure of the work obligations, PSAs contemplate a series of legal implications. If a contractor fails to implement exploration and development programs during the scheduled timeframe, SOCAR has the right to unilaterally terminate the PSA agreement, excluding force majeure cases. In such an event, any costs incurred during the exploration and any bonuses are not recoverable.[45]

LEGAL STATUS OF AZERBAIJANI PSAs

Each PSA contract becomes a law of the Azerbaijani state, including contractors' rights and interests. However, the contracts pass through different processes before coming into force. First, a PSA is negotiated between SOCAR and AIOC and then is passed on to the various government departments, which may suggest amendments. The contract then has to be ratified by the parliament before finally being signed by the president.[46] Although it seems a rather cumbersome procedure, it has not been a deterrent for potential foreign investors.[47]

According to Sabit Bagirov, former president of SOCAR, ratification of PSA contracts by the parliament (Milli Majlis) was due to the lack of an oil law in the country when the contracts were signed.[48]

Azerbaijan currently lacks legislation specifically governing the oil and gas sector. The legal framework for the regulation of oil and gas contracts in Azerbaijan is supposed to be based on two acts: the Subsoil Act (February 1998) and the Energy Act (November 1998). Despite the fact that both provide a general framework for exploiting energy resources, their provisions clash with each other in many instances. It is also not clear if the Energy Act is superior to the Subsoil Act. Moreover, most existing PSAs do not meet the provisions of these acts.[49]

Although a draft law of oil and gas was submitted to the parliament, it was not adopted. Even if adopted, it was going to be applied to future PSAs, not to the ones that already existed. This law was meant to outline a procedure for concluding PSAs without the need for parliamentary ratification. *"Perhaps, the government's success in attracting foreign investment into the oil and gas sector has made it reluctant to adopt oil and gas laws that might have changed the existing PSA process polished over the years."*[50]

The president of Azerbaijan signed a decree founding the Ministry of Industry and Energy (MIE) in 2001, in order to improve the preparation and implementation of state policy. SOCAR is charged with conducting commercial functions while MIE is assigned to non-commercial functions, such as preparing, negotiating, and implementing PSAs and other types of contracts on behalf of the government. However, in reality, MIE has been accorded only nominal responsibility for concluding PSAs.[51] SOCAR is a contractor and has its own share in contracts. At the same time, it represents the government in these contracts. The company is interested in increasing its shares, which in its own turn might reduce the revenues of the Azerbaijani government. This situation exists because of a lack of law regulating the sector and SOCAR continues to have considerable power and influence. Furthermore, Azerbaijan also lacks a modern and independent agency that could set basic rules and procedures on oil and gas operations, pipeline and environmental regulations, and the establishment of tariffs.[52]

Subsequently, PSA contracts in the country lack the control of atmospheric emissions. Existing PSA agreements were drafted with the development and production of crude oil in mind and treated natural gas as a byproduct. In order to regulate petroleum pollution, gas flaring, and venting, Azerbaijan needs to consider investment incentives coupled with environmental taxation measures, such as carbon taxes, emission trading, and capping in future PSAs.[53]

When it comes to the status of PSAs within the Azerbaijani legal system, there are unresolved legal anomalies, as they have been drafted in the form of contracts between private partners but have been passed into law by the parliament. Nevertheless, one of the requirements of Azerbaijan's

44 Ciaretta, A. and S. Nasirov. Development Trends in the Azerbaijan Oil and Gas Sector: Achievements and Challenges. Energy Policy, 2011, Vol. 40, p. 289.

45 Mustafayev, N. Production-sharing agreements in the petroleum industry of Azerbaijan. Journal of World Energy Law and Business, 2015, Vol. 8, No. 4, p. 374.

46 Ciaretta, A. and S. Nasirov. Development Trends in the Azerbaijan Oil and Gas Sector: Achievements and Challenges. Energy Policy, 2011, Vol. 40, p. 289.

47 Mustafayev, N. Production-sharing agreements in the petroleum industry of Azerbaijan. Journal of World Energy Law and Business, 2015, Vol. 8, No. 4, p. 370.

48 Ibid.

49 Bindemann, K. Production Sharing Agreements: An Economic Analysis. OIES WPM, October 1999, Vol. 25, p. 72.

49 Bindemann, K. Production Sharing Agreements: An Economic Analysis. OIES WPM, October 1999, Vol. 25, p. 72.

50 The Economist. Azerbaijan Regulations: Oil and Gas Law to facilitate PSAs. Intelligence Unit, Country Briefing, May 2001.

51 Gojayev, V. Resource Nationalism Trends in Azerbaijan 2004-2009. RUSSCASP, March 2010, p. 11.

52 Ciaretta, A. and S. Nasirov. Development Trends in the Azerbaijan Oil and Gas Sector: Achievements and Challenges. Energy Policy, 2011, Vol. 40, p. 290.

53 Mustafayev, N. Production-sharing agreements in the petroleum industry of Azerbaijan. Journal of World Energy Law and Business, 2015, Vol. 8, No. 4, pp. 381-382.

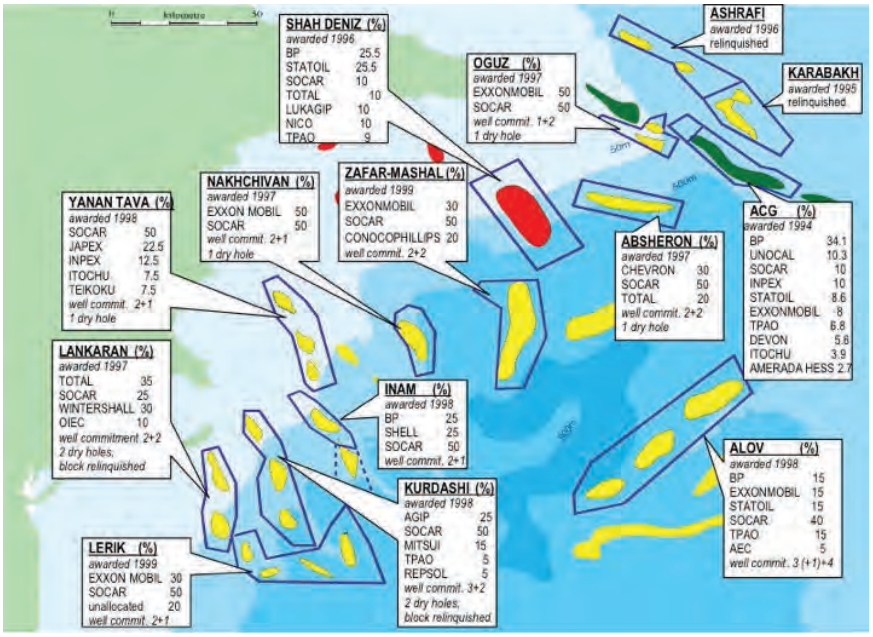

Figure 3: Offshore fields by ownership 2011
Source: Bit Tooth Energy[62]

constitution of 1995, regarding the enforceability of a law, is that a law must be officially published[54] and has to be available to the citizens of the country, which is not the case. Only the contracts of two deposits (ACG and Shah Deniz) are available on the website of the AIOC.[55] To date, no PSA's text has ever been officially published, and this could mean that PSAs have technically never entered into force. According to Alum Bati, a legal advisor, these PSAs are in fact not laws but remain as contracts, which are given the force of law. It is possible the reason for the PSAs not being published is that they contain "state secrets," but this is also not grounded, since, according to the Law on Normative Legal Acts of 1994, hydrocarbon reserves do not fall under the category of state secrets.[56]

Alternatively, some experts view Azerbaijani PSAs not as laws, but rather international treaties. This approach would explain their ratification. Nevertheless, a question arises about how it is possible to have an international treaty between a number of private enterprises and one or more state oil companies (SOCAR, Statoil, etc.). Under the Law on the Conclusion, Execution, and Denunciation (LOCEDIT), adopted in 1995 by the Azerbaijan Republic, international treaties may only be made with foreign states and international organizations.[57]

The legal nature of Azerbaijani PSAs is also characterized by some as a service contract whereby a contractor (IOC) provides E&P services to SOCAR in oil and gas fields in return for remuneration from a share of produced oil or gas as consideration for its services.[58]

Thus, the current legal petroleum regime in Azerbaijan can be evaluated as a discretionary system scattered through a number of laws (on subsoil, energy, foreign investment, taxes, land, and the environment, just to name a few), where the terms of each PSA is subject to negotiation and agreement between SOCAR and IOCs.[59]

On the other hand, it seems like the hybrid nature of Azerbaijani PSAs does not bother foreign contractor parties. Either SOCAR misrepresented that contracts are in compliance with the constitution, legal formalities, and procedures of the Azerbaijan Republic, or contractor parties have been willing to overlook the fulfillment of certain formalities since the treatment of PSAs as law provide them with certain protection that an ordinary contract would not.[60]

Not long ago, SOCAR decided to renew the Contract of the Century after 22 years since its signing. In May 2016, the company submitted final proposals to its foreign co-venturers on a new contract for the development of Azeri-Chirag-Guneshli (ACG) offshore oil fields' block, and is currently waiting for their answer.[61] The ball is now in the court of the IOCs.

The signing of the new PSA agreement is expected to take place in September 2016, which will annul the previouscontract signed for a period of 30 years before reaching maturity and extend joint development and production works in the given fields for the next 25 or 30

54 Bati, A. The Legal Status of Production Sharing Agreements in Azerbaijan. Journal of Energy & Natural Resources Law, 2003, Vol. 21, No. 2, pp. 154-167.

55 Bagirov, S. Azerbaijan's Oil Revenues: Ways of Reducing the Risk of Ineffective Use. Jan 2007, p. 20.

56 Bati, A. The Legal Status of Production Sharing Agreements in Azerbaijan. Journal of Energy & Natural Resources Law, 2003, Vol. 21, No. 2, p. 160.

57 Ibid pp. 164.

58 Mustafayev, N. Production-sharing agreements in the petroleum industry of Azerbaijan. Journal of World Energy Law and Business, 2015, Vol. 8, No. 4, pp. 365.

59 Ibid. p. 363.

60 Bati, A. The Legal Status of Production Sharing Agreements in Azerbaijan. Journal of Energy & Natural Resources Law, 2003, Vol. 21, No. 2, pp.165-167.

61Gasnali, A., Parfyonova, I., 2016. SOCAR представила иностранным партнерам предложения по новому крупному нефтяному контракту. Trend News Agency [Accessed: May 30, 2016] Available at: http://www.trend.az/business/energy/2538504.html

62 Bit Tooth Energy, 2011. Oil and gas fields off Azerbaijan. BitTooth, [Accessed: May 30, 2016] Available at: http://bittooth.blogspot.ru/2011/12/ogpss-looking-at-azerbaijan-future-fuel.html

years, on the basis of mutual consent amongst partners. The new contract will go through the ratification process in the parliament and be signed by the head of state as well.[63]

The act should be considered the continuation of the previous PSA, with new terms rather than amendments. In accordance with the new PSA, Azerbaijan's share in oil profits will continue from 80 percent, not to start over again from 30 percent, as the country will make investments itself this time. In return, foreign partners will take responsibility for the application of cutting-edge technologies and systems for constructing new platforms, achieving more effective extraction of reserves located in the contractual area, and more precise measurement of geological layers.[64]

With this new contract, Azerbaijan creates an environment for foreign companies to invest in its oil fields, which are getting old. On the other hand, prolonging the already existing contract before it matures is also in IOCs' best interests, as they are sure about the existence of real reserves in the contractual area and there is almost no risk involved for them. Every energy company desires to have stable production in the region, with which it is already familiar.[65]

DARK AZERBAIJANI PSAs

Usually in rentier states, politically connected business interests benefit tremendously from their control of lucrative fields, especially in the oil and gas sector. Three PSA contracts ratified by the Azerbaijani parliament in 2009 were shrouded in mystery and neither SOCAR nor MIE informed the public about these PSAs and the involved oil companies. It was the first time that PSA contracts were signed in secrecy and without the usual pomp in Azerbaijan.[66]

Some argue that information in these PSA agreements and participating new oil companies is intentionally kept undisclosed from the public and such an argument bolsters speculation among the general public that these oil companies, which were registered overseas, are indirectly owned or related to ruling elites.[67]

These little-known new oil companies never seem to provide information on their activities or production interests. An oil expert's research found that the mentioned PSAs were actually signed on the SOCAR premises on February 3, 2009 and that the public did not know about them for 104 days– until the contracts were submitted to the parliament. Two of these PSAs were concluded with a little-known oil company represented by a Russian citizen. Under the contract, SOCAR had only a 20 percent share, while the contracting company's share was to be an 80 percent stake. This offshore oil company, Global Energy Azerbaijan Ltd., was registered in British Virgin Islands, has been kept secret to the public and the media, and continues to exploit 17 oil fields in Azerbaijan. [68]

MAIN POLICY TAKEAWAYS ON AZERBAIJANI PSAs CONTRACTS

Azerbaijan has established a stable and attractive environment for foreign investors. After the collapse of the Soviet Union, the government adopted strategies to ensure the legal protection and profitability of foreign investments. Foreign companies in the oil industry prefer countries that can offer political stability and predictable legal and regulatory frameworks. In the mid-1990s, the investment environment and fiscal regime created by Azerbaijan for PSAs offered more attractive terms than similar contracts in other Caspian Basin countries. Under these contracts, foreign contractors are exempt from paying royalties, value added taxes, excise duties, excess profit taxes, export duties, property taxes, and land taxes. Besides, the elimination of banking restrictions (including no restrictions on foreign bank accounts, payroll currency, and dollar withdrawals), the implementation of the international accounting system, the elimination of various government audits, and the application of international practices on labor laws, make Azerbaijani PSAs more attractive to potential foreign investors.

Most likely, PSA agreements will continue to be the main type of petroleum contract for Azerbaijan in the future. However, the government needs to renegotiate its oil contracts to ensure more favorable terms for the country and increase revenue from its hydrocarbon reserves.

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63 Personal interview with Ilham Shaban, Head of Oil Studies Center, Azerbaijan.

64 Ibid.

65 Ibid.

66 Gojayev, V. Resource Nationalism Trends in Azerbaijan 2004-2009. RUSSCASP, March 2010, pp. 19.

67 Ibid.

68 Ibid.

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OPINION

RUSSIAN APPROACHES AT COP21
THE DISPROPORTIONATE REACTION BY THE WEST

Michael Roh

Abstract

Russia, the country with the largest natural gas reserves in the world, is notably one of the largest greenhouse gas emitters. Therefore, its participation is crucial to the legitimacy of any international climate change agreement. At the 21st meeting of the Conference of the Parties in Paris, referred to as COP21, Russian President Vladimir Putin delivered the message that climate change is a global threat and Russia is ready to act. Western media lambasted the leader and criticized his intentions. This paper seeks to identify where Russia stands on climate change, whether its Intended Nationally Determined Contribution is sufficiently ambitious, and why taking steps to curb climate change is in the country's interests. The potential to introduce renewable energy and the barriers to initiating renewable projects are also discussed.

Key words: climate change; COP21; Paris Agreement.

At the 21st Conference of the Parties on Climate Change (COP21), no one expected Vladimir Putin, in his address to the U.N. Member States, to declare that governments must act against global warming. Putin even took the opportunity to boast of Russia's significant contributions already made to combatting climate change.

Could the West's go-to villain actually care about climate change? Is Putin correct in claiming Russia has already made efforts to reduce emissions? Given that the consequences of climate change affect countries disproportionately, could it actually be in Russia's interest to combat global warming? Should the West be so quick to lambast a country willing to cooperate, when that country is responsible for such a significant share of global greenhouse gas emissions, a country that depends on its fossil fuel exports to sustain its economy?

These are all questions this paper will seek to answer, identifying individual points in Putin's speech at COP21 to uncover Russia's true intentions when it comes to climate change.

Building on the efforts of the UNFCCC[1] and the negotiatedcommitments in the Kyoto Protocol, the Paris Agreement was adopted on December 12, 2015. While the Kyoto Protocol sought to rally countries to reduce emissions in an effort to keep global temperatures from rising more than 2 degrees Celsius above pre-industrial levels, the Paris Agreement ambitiously strives to stop temperatures reaching above 1.5 degrees Celsius.[2] Scientists agree that allowing temperatures to exceed this threshold will have devastating and far-reaching environmental consequences.[3] For the Paris Agreement to come into force, 55 countries (accounting for at least 55 percent of GHG[4] emissions) must ratify the treaty.[5] Countries were advised to submit an INDC[6] before the conference, and Russia was one country that submitted its INDC months before the conference, committing to cutting its greenhouse gas emissions by 25 to 30 percent of their 1990 levels by 2030.[7]

The Kyoto Protocol required countries to keep emissions of six greenhouse gases below levels of the base year (1990), which Russia committed to for the 2008-2012 period.[8]For Russia, this has been a rather easy task, considering the early 1990s was a time when the Soviet Union's heavily energy-intensive industrial economy collapsed. Figure 1 displays the sharp decrease in emissions for Russia in the early 1990s. Therefore, it's hard to ignore that Putin is taking too much credit for achieving a less-than-ambitious

1 *United Nations Framework Convention on Climate Change*

2 *United Nations Framework Convention on Climate Change, 2016. Background on the UNFCCC: The international response to climate change. Available at: http://unfccc.int/essential_background/items/6031.php [Accessed: May 30, 2016]*

3 *World Resources Institute, 2016. Understanding the IPCC Reports. [online] Available at: http://www.wri.org/ipcc-infographics [Accessed: May 30, 2016]*

4 *Greenhouse gas*

5 *TASS, 2016. Russia signs Paris Agreement on Climate Change. TASS, [online] 22 April. Available at: http://tass.ru/en/politics/871982 [Accessed: May 30, 2016]*

6 *Intended Nationally Determined Contribution*

7 *Climate Action Tracker, 2016. Russian Federation. [online] Available at: http://climateactiontracker.org/countries/russianfederation.html [Accessed: May 30, 2016]*

8 *Pearce, F., 2004. Russia set to approve climate change plan. The New Scientist, [online] 30 September. Available at: https://www.newscientist.com/article/dn6467-russia-set-to-approve-climate-change-plan/ [Accessed: May 30, 2016]*

target. The graph also displays, however, emissions from the U.S., where emissions only started to decrease in recent years, due to the shale revolution, which one could argue is also convenient, given that natural gas burns much cleaner than oil.

In Paris, Putin took the opportunity when addressing fellow U.N. member states at COP21, to boast that Russia has already made a significant contribution in the fight against climate change while still growing economically. Regarding emissions, Putin boasted of how Russia has reduced its energy consumption by 33 percent from 2000-2012, while projecting a further 13 percent reduction between 2015 and 2020. Additionally, 46 million tonnes of CO2 were not released into the atmosphere thanks to Russia's industrial modernization and clean technology. Putin proudly claimed these achievements were made while doubling Russia's GDP. It's true that Putin is taking undue credit, but that same moral standard should be placed upon other developed countries, including the U.S.

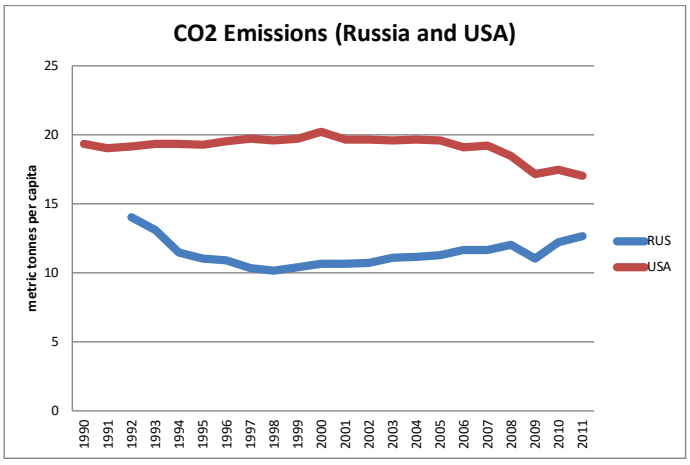

Figure 1
Source: World Bank[9]

Putin also spoke on the importance of forests, which act as carbon sinks. A carbon sink is "anything that absorbs more carbon than it releases."[10] Indeed, vast areas of Russia are forests, with estimates stating the country contains 640 million trees.[11] This allows Russia to negate a generous share of its emissions through the effects of its forests. In fact, after accounting for forestry, Russia's INDC proposal to reduce GHGemissions by 25 to 30 percent below 1990 levels by 2030, is actually only a reduction of 6 to 11 percent below the 1990 level.[12]

9 *Graph produced by author from World Bank data http://databank.worldbank.org/data/reports.aspx?source=2&type=metadata&series=EN.ATM.CO2E.PC#*

10 *Fern, 2016. What are carbon sinks? [Accessed: May 30, 2016] Available at: http://www.fern.org/campaign/carbon-trading/what-are-carbon-sinks*

11 *Poberezhskaya, M., 2015. Paris climate talks: Russia will use its huge forests as a bargaining chip at COP21. International Business Times, [Accessed: May 30, 2016] 20 November. Available at: http://www.ibtimes.co.uk/paris-climate-talks-russia-will-use-its-huge-forests-bargaining-chip-cop21-1529685*

12 *Climate Action Tracker, 2016. Russian Federation. [Accessed: May 30, 2016]Available at: http://climateactiontracker.org/countries/russianfederation.html*

WHY CLIMATE CHANGE ACTION IS IN RUSSIA'S INTERESTS

Despite claims by Western media that Putin is only pretending to care about climate change because of a hidden agenda, namely, diverting attention away from the situations in Syria and Ukraine, some believe Russia is looking to increase its soft power by showing the world it is a cooperative partner. Russia, once a country that received aid, seeks to gain the prestige that comes with being a donor country.

The International Business Times wrote, "Russia has a reputation as one of the most difficult states involved in international climate negotiations – and don't expect things to change at the latest UN conference in Paris. After all, this is a country with vast oil and gas reserves, brutal winters and a strong sense of economic self-interest."[13] *The New York Times* wrote, "If the other leaders' jaws did not drop, it was only because they were being polite. The remarks were a departure from Mr. Putin's years of publicly mocking the issue. In 2003, for example, he noted that climate change could have the advantage of causing Russians to spend less on fur coats... Were Mr. Putin's statements merely further attempts to win a place back in the international fold, after he was marginalized because of Russia's aggression in Crimea, eastern Ukraine and Syria? Or were his remarks a sincere attempt to be a team player as almost 200 countries try to reach a climate deal?"[14] This author does not doubt that any of these reasons are false and that they did not influence Putin's decision to appear cooperative. But is it possible that climate change is a real threat to Russia's interests?

Some climate change skeptics in Russia believe that the effects of climate change will benefit Russia (melting permafrost would open the Arctic regions for oil and gas production and the Northern Sea Route for trade, more agricultural opportunities with warming temperatures in previously non-arable land, etc.). Regarding the possibility of fuel production in the Arctic, technology has broken these barriers and recent news of the world's biggest icebreaker suggests Russia will find a way.[15] And, of course, there is the Yamal project.[16] The Northern Sea Route does not seem to be

13 *Poberezhskaya, M., 2015. Paris climate talks: Russia will use its huge forests as a bargaining chip at COP21. International Business Times, [online] 20 November. Available at: http://www.ibtimes.co.uk/paris-climate-talks-russia-will-use-its-huge-forests-bargaining-chip-cop21-1529685*

14 *Davenport, C., 2015. A Change in Tone for Vladimir Putin's Climate Change Pledges. The New York Times, [Accessed: May 30, 2016] 1 December. Available at: http://www.nytimes.com/interactive/projects/cp/climate/2015-paris-climate-talks/vladimir-putin-climate-change-pledges-russia*

15 *Lockhart, K., 2016. Russia floats out 'world's biggest' nuclear-powered icebreaker. The Telegraph, [[Accessed: May 30, 2016] 17 June. Available at: http://www.telegraph.co.uk/news/2016/06/17/russia-floats-out-worlds-biggest-nuclear-powered-icebreaker/*

16 *Novatek, 2016. Yamal LNG. [Accessed: May 30, 2016]Available at http://www.novatek.ru/en/business/yamal-lng/*

a compelling enough reason either, as low oil prices have diminished the investment attractiveness of this shipping route.[17] As for the prospects of increased grain production possibilities, it's difficult to address such a ridiculous notion.

Whether Putin's comment was a joke and the humor was lost on Western journalists or whether Putin has simply changed his tone, today's Russia acknowledges that global warming conflicts with Russia's interests. Eroding shorelines, the impact on permafrost areas (which account for 60 percent of its territory), increased duration of wildfires in Siberia, and desertification of the Caspian are only a handful of the many ways climate change can rear its ugly head in Russia.[18,19]

According to the Russian Ministry of Natural Resources and Environment, average temperatures in Russia are warming 2.5 times faster than the Earth's average.[20] The Minister of Natural Resources and Environment, Sergei Donskoy, stated, "extreme weather could cut Russia's economic output by 1-2 percent every year for the next 15 years."[21] Just last year, the wildfires that blazed across Siberia covered the lake "Pearl of Siberia" in ash. Furthermore, former president Dmitry Medvedev initiated the law punishing companies who did not utilize 95 percent of their associated petroleum gas, significant given the country's history of gas flaring.[22]

CURRENT RUSSIAN INITIATIVES AND THE POTENTIAL FOR GROWTH IN THE RENEWABLE ENERGY SECTOR

Russia already possesses a highly skilled work force to develop its renewable energy sector. In the 1930s, the USSR was the first country to begin constructing utility-scale wind turbines.[23] And developing the renewable energy sector comes with massive benefits for the population. Roughly 16 million families own countryside homes (called dachas), where there is great potential for renewable-energy demand.

Russia's vast territory allows for ample opportunities to harness energy produced by the sun and wind. Solar energy could be harnessed in the southwestern regions, including the North Caucasus, Black and Caspian Sea regions, Southern Siberia, and the Far East. The average radiationlevel is 1400 kWh/m2 per year. Wind energy could be developed in the coastal areas, particularly in the Far East and Black Sea regions.[24] Therefore, the potential is there. But is the intention? In 2009, Russia's energy plan included a goal of increasing the percent of energy from renewables to 4.5 percent by 2020.[25] In an article written by Medvedev in 2009, he illustrates his desire to move away from the "habit of relying on the export of raw materials."[26]

The barrier to these projects is therefore not lack of will, but the requirement of significant capital and technology, which Russia is currently having difficulty in accessing. Western sanctions initiated after the Crimea incident blocked access to Western financial markets and this has had the unintended effect of limiting Russia's ability to go green. Renewable energy projects require much capital expenditure. I spoke with Maxim Titov, of the World Bank, who remarked how energy efficiency financing projects, which were gaining momentum before the sanctions, are indefinitely stalled.

There is hope, however. Current initiatives include work by RUSNANO, which Putin mentioned in his COP21 speech, which has produced a nanotube technology with the ability to reduce waste when applied to the manufacturing of certain materials.[27] Another company, Renova, has collaborated with the solar technology manufacturer, Hevel, which already runs three solar farms and recently opened a solar panel manufacturing plant. The company aims to invest 450 million USD in solar technology in the next three years.[28] Nevertheless, little growth is expected until the sanctions are lifted, as access to Western financial markets and technology is crucial to its development.

23 Clark, W., 2015. Russian Resources Start to Flow into Renewable Energy. The World Post,[Accessed: May 30, 2016] Available at: http://www.huffingtonpost.com/woodrow-clark/russian-resources-start-t_b_8215902.html

24 Katona, V., 2016. Realizing Russia's renewable energy potential in 2017. Russia Direct, [Accessed: May 30, 2016]1 February. Available at: http://www.russia-direct.org/opinion/realizing-russias-renewable-energy-potential-2017

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26 Medvedev, D., 2009. Dmitry Medvedev's Article, Go Russia! President of Russia, [Accessed: May 30, 2016]10 September. Available at: http://en.kremlin.ru/events/president/news/5413

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28 Ibid.

17 TASS, 2016. Investment attractiveness of Northern Sea Route falls with dwindling oil price. TASS, [Accessed: May 30, 2016]20 May. Available at: http://tass.ru/en/economy/877090

18 Clark, W., & Elkin, D., 2015. Russia joins other nations in a historic climate change agreement. Russia Direct, [Accessed: May 30, 2016]14 December, Available at: http://www.russia-direct.org/opinion/russia-joins-other-nations-historic-climate-change-agreement

19 Katona, V., 2016. Realizing Russia's renewable energy potential in 2017. Russia Direct, [Accessed: May 30, 2016] 1 February. Available at: http://www.russia-direct.org/opinion/realizing-russias-renewable-energy-potential-2017

20 TASS, 2016. Russia signs Paris Agreement on Climate Change. TASS, [[Accessed: May 30, 2016] 22 April. Available at: http://tass.ru/en/politics/871982

21 Kuzmin, A., 2015. Russian media take climate cue from skeptical Putin. Reuters, [Accessed: May 30, 2016] 29 October. Available at: http://www.reuters.com/article/us-climatechange-summit-russia-media-idUSKCN0SN1GI20151029

22 The World Bank, 2013. Igniting Solutions to Gas Flaring. [Accessed: May 30, 2016] Available at: http://www.worldbank.org/en/news/feature/2013/11/12/igniting-solutions-to-gas-flaring-in-russia

CONCLUSION

The intention of this paper is not to persuade Western media outlets to be less hypercritical toward Russia, as it is obviously a futile effort. Rather, this author urges policymakers not to align themselves with those who see international affairs through the lens of us vs. them. Climate change action is already the quintessential collective action problem and all parties must be willing to set aside contentious issues and work together, especially when parties are willing. Moreover, the West must reevaluate its approach to characterizing Russia. For all the accusations from the West that the Russian media is corrupt and unreliable, perhaps Western journalists should be careful not to criticize Russia for the sake of criticizing Russia. Many Russians already believe that Western media is disproportionately critical of Russia. Bashing Putin for his climate change concerns, genuine or not, is counterproductive to the greater good. The motivations are certainly geopolitical. This explains why Saudi Arabia, the controversial and notably oil-rich U.S. ally, wasn't subjected to the same criticism, despite actively trying to block an agreement, taking issue with the more ambitious 1.5-degree Celsius goal, while it, being one of the richest countries in the world, refused to financially assist countries in weaker economic positions.[29] Indeed, Russia's emissions commitments are less than ambitious, but they are certainly significant.

Speaking at the opening of the Saint Petersburg International Economic Forum, which took place June 16-18, as this author penned this conclusion, U.N. Secretary General Ban-Ki Moon stressed the need for countries to adopt the Paris Agreement on Climate Change, while also thanking Russia for signing the crucial document. The West should take a cue from UNSG Ban-Ki Moon and welcome Russia's commitment to climate change, because global warming doesn't care about geopolitics and achieving progress will require all hands on deck.

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29 Ayed, N., 2015. Climate talks contend with both villains, heroes as deadline looms. CSC News, [Accessed: May 30, 2016]8 December. Available at: http://www.cbc.ca/news/world/climate-talks-contend-with-both-villains-heroes-as-deadline-looms-1.3355327

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WORKSHOP REVIEW

RUSSIA AND IRAN: PAST, PRESENT AND FUTURE

Dr. Gevorg Avetikyan and Zachary Waller

Abstract

Iranian ambassador to Russia Mehdi Sanaei visited EUSP and spoke about the long history of Russian-Iranian relations. The ambassador covered topics including the multipolar world, the different dimensions of the Russian-Iranian relationship, and, of course, sanctions – both against Iran and against Russia. After covering the topics he wanted to speak about, he opened the floor to questions and, speaking in both English and Russian, answered some tough questions from the students and other academics in attendance.

Key words: Iran; Russia; sanctions.

On April 8th, Mehdi Sanaei Ambassador of the Islamic Republic of Iran to the Russian Federation, visited the European University at St. Petersburg to speak with students, faculty, and other members of the EUSP community. Mr. Sanaei covered a wide range of topics in his conversation at EUSP, but focused on Iran's relations with Russia and the Soviet Union.

RELATIONS BETWEEN IRAN AND RUSSIA: HISTORICAL SKETCH

Relations between Russia and Iran in the second half of the 20th century up until the current period can generally be divided into three large stages: between WWII and the Islamic Revolution in Iran; between the beginning of the 1980s and the collapse of the USSR; and the modern stage of relations with Russia.

During the second period, Iran had several reasons to mistrust the USSR: one being the fact that the USSR did not want to withdraw its troops from Iranian territory. At the same time, the Communists were quite a strong political force in Iran, another reason for Iran to be cautious. The Iranian monarchy nevertheless had relations with the USSR – Mohammad Reza Shah even paid two official visits to the USSR and relations were generally better in the 1960s and late 1970s.

The Iranian revolution changed the landscape at the end of the 1970s. The Iran-Iraq war (1980-1988) became a new challenge and Iranians did not appreciate the fact that notonly the US but also the USSR was selling arms to Iraq.

Thus, Iran has chosen to adhere to its own principles, put shortly as "Neither East, Nor West - Islamic Republic!"

The third stage of bilateral relations started with the Soviet collapse. Throughout the past couple decades, Iran has had different presidents (conservatives, reformers, moderates) and Ambassador Sanaei also identified three dimensions of Iran-Russia relations at this latest stage of their relations.

The International Dimension

Russia and Iran take similar positions in terms of world politics. Both nations stand for a multipolar world as opposed to creating a unipolar system of international relations.

Both nations are against the application of double standards. "They tell Russia that Ukraine's people should choose their own president, but we think the same should be in Syria. It should be the Syrians to decide, not the USA, Qatar, Saudi Arabia or Turkey," said Ambassador Sanaei. If the Arab Spring is possible in Egypt, it could be possible in Yemen and Bahrain as well.

The Regional Dimension

One of the brightest examples of Russian-Iranian cooperation was overcoming the crisis in Tajikistan in the 1990s. The Central Asian republic was torn apart by civil war and it was the joint efforts of Russia and Iran that helped stabilize the situation. Russia and Iran have also co-operated to solve the Nagorno-Karabakh issue. Just recently, the foreign ministers of Iran, Russia and Azerbaijan met to discuss the conflict. Russia and Iran have cooperated in the Caspian Sea region as well.

There is active ongoing cooperation in the Middle East, including serious coordination in Syria.

The Bilateral Dimension

Ambassador Sanaei started with pointing out that all possible elements of bilateral relations that can exist between two states (such as politics, economics, culture, academia) do exist and work between Iran and Russia. Therefore, "the Iranian Ambassador to Russia is a very busy man". There is one negative thing, however: Despite the strategic nature of these relations, the volume of trade is not very big. Efforts are being taken to improve this and there have been many joint consultations, such as the seven meetings between the two countries' presidents over the last two years. However, the turnover in bilateral trade is still below $2 billion.

FOR STUDENTS IN THE ENERPO PROGRAM, ONE TOPIC REALLY STRUCK A CHORD: SANCTIONS

On June 28, 2012, the United States of America imposed sanctions on Iran in a bid to dissuade the Islamic Republic from pursuing its nuclear program. This sanctions regime targeted Iran's central bank, punishing any bank, company or government doing business with it. Additionally, the American sanctions regime targeted the Iranian energy sector specifically, promising to punish anyone helping to grow it. Just a few days later, on July 1, 2012, the European Union placed an oil embargo against Iran. This, coupled with the United States' sanctions, caused Iranian oil output to plummet.

While many of the sanctions on Iran were recently lifted, the topic was a hot one at Ambassador Sanaei's visit, as the Russian Federation was placed under sanctions by the United States and European Union in March of 2014 in response to Russia's annexation of Crimea.

For Ambassador Sanaei, sanctions are a terrible thing not to be wished upon any country. He specifically cited the Iranian experience, claiming the sanctions hurt the lowest in Iranian society, as many poor Iranians were unable to afford the medicines they needed to survive when the country was first placed under sanctions.

Gevorg Avetikyan introduces the Ambassador

The ambassodor speaks in the Golden Hall

However, Ambassador Sanaei also pointed out there can be positive outcomes of sanctions. For example, as a result of the lack of access to medicine, Iran created a strong pharmaceutical industry that now exports large amounts of drugs. Additionally, before sanctions were imposed against Iran, 80% of the state budget was dependent on oil and gas. After the sanctions were finally removed, only 40% of the budget was dependent on oil and gas.

Ambassador Sanaei was also quick to point out the help Russia offered Iran while the country was under sanctions. He pointed out that when things were particularly bad in Iran, Russia was there trying to stabilize the situation. Additionally, Russia played a large part in helping to broker the nuclear deal that ultimately saw the sanctions lifted.

As for the current sanctions against Russia, the ambassador said he did not believe they were all that serious, with the exception being the sanctions related to access to the financial system (which he said are always painful). He said that Iran used to tell Russia there was nothing to be afraid of with sanctions, but noted Russian-Iranian trade was down 70% (by volume) as a result.

Sanctions look to be an important part of the Russia-Iran relationship. During the time of sanctions against Iran, it was Rosatom that helped Iran build its nuclear plants. Additionally, it was Russia that worked hard to get the sanctions lifted and get Iran back into the world system (just in time for Russia itself to be sanctioned).

Even though Russia is now under sanctions, Ambassador Sanaei noted that the Russian Federation is continuing to help Iran develop, with Russia announcing it will put $5 billion into various projects in Iran.

This is positive news for Iran, especially if some of that money goes to support Iran's small natural gas industry. Unlike Russia, who exports huge amounts of natural gas, Iran has some of the world's largest natural gas reserves but is

Ambassador Mehdi Sanaei

responsible for less than 1% of the world's natural gas trade. This is due to several factors, such as lack of LNG export terminals, lack of sufficient export pipelines, dearth of suitable neighbors to build pipelines through, and the lower quality of Iranian gas, which means it needs to be treated before being exported. However, even with all of those going against Iranian gas, there is one overarching point bearing the most responsibility: sanctions. With sanctions specifically targeting the energy sector, Iran simply could not develop its natural gas capabilities to anywhere near the level it could have otherwise.

Overall, Ambassador Sanaei provided a comprehensive view of Russian-Iranian relations and opened the eyes of many students who had never before heard such a perspective. So where are relations headed for the future? As countries with similar world outlooks (both desiring multipolar worlds and a decreased role of the United States) and similar experiences under sanctions (almost bonding them together), Iran and Russia look set to continue bettering relations.

THE LECTURE WAS FOLLOWED BY A Q&A SESSION

Deje Holmes: Is economics the only challenge to Russian-Iranian relations?

Mehdi Sanaei: There are no challenges between Iran and Russia.

Olga Dragan: What are the reasons why relations between Russia and Iran do not expand?

Mehdi Sanaei: The Chief reason is that both countries are primarily exporting energy resources. Both are struggling with dependence on energy export revenues. Iran has progressed significantly. 80% of its budget used to be dependent on oil and gas exports, but in the 2015 budget that share was decreased to below 40%. In terms of agriculture, for example, Russia exports what Iran needs to import (grain, corn, etc.), and Iran exports things Russia needs (fruits, for example). We are solving the issue to make it possible for Iran to also export meat, dairy, and other products to Russia.

Michael Roh: What would your advice be for Russia under sanctions and do you think sanctions are acceptable foreign policy measures?

Mehdi Sanaei: Sanctions did affect Iran's economy and they did so in Russia as well, but we've always said don't be afraid of sanctions. They're not as scary as they seem. Compared to what Iran had to go through, the anti-Russian sanctions are not that serious. Sanctions generally are harmful, but you can use sanctions as well.

Aaron Wood: After lifting of sanctions Iran will try to regain its share in hydrocarbons market in Europe, how can this affect Russia-Iran relations?

Mehdi Sanaei: When we study Iran-Russia relations, we talk about negative effects of third sides. We believe bilateral relations should be originally developed, not affected by third sides. We hope Russia-Iran relations will develop on a side, on their own.

Pierre Jouvellier: There are reports of a $7-billion weapons sale deal, can you comment more about cooperation in the defense sector?

Mehdi Sanaei: Relations are varied. For example, Iran supplies Russia with fruits, dried fruits, raisin, nuts, carpets, construction materials. Iranian cars (Iran Khodro) for middle-class Russians used to be exported. Iran also exports pharmaceuticals. Iran imports some agricultural products from Russia.

Russia has traditionally been active in two spheres: construction of power stations and railroads. In the past years, we have signed contracts for nuclear power plant construction, the modernization of Iran's railroad system. We're working on the realization of a $5 billion credit fund by Russia to support Iranian-Russian projects.

Sanaei's avoidance of this particular question is likely due to his not being authorized to speak about issues the Iranian government views as particularly sensitive, at least not without having directive to do so from Tehran.

Alexander Kamprad: Russia is critical about the way Germany treats the migrant crisis. What would your comment be?

Mehdi Sanaei: Iran has had migrants from Afghanistan and Iraq. Millions of them, especially from Afghanistan. There were no mass migrations from Syria though. For some reason everyone wants to go to Europe, not even the Arabic-speaking Persian Gulf states, only Europe.

Iran, like Russia, backs the Assad government in Syria. In deflecting this particular question, it appears the ambassador is trying to avoid getting between one of his country's major allies and a major world crisis.

Dr. Gevorg Avetikyan

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THE ENERPO JOURNAL

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