Investment and Market Structure in the South Caucasus and Central Asia: before and after the accession to the ECT

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Focus of Presentation:

- Objectives and Scope of the Study
- Methodology
- Preliminary findings

Objectives

- Discover evidence of the ECT principles in the restructuring of the energy sector of Contracting Parties (Armenia, Azerbaijan, Georgia, Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan and Uzbekistan) before and after their accession to the Treaty.

- Energy Charter Treaty principles mobilize FDI & facilitate market restructuring.
- Timeframe: 1998 (ECT entry into force) – 2010 (Moldova's accession to the Energy Community)

Scope

- **Horizontal comparative analysis** of energy policy, legislation/regulation in target countries with a view to identify the role of the ECT's principles and highlight the areas in need for improvement.
- Analysis based on a **matrix of selected indicators** in the market structure and the investment climate.
- **Sources of information:** ECT ICMS, official statistics, country legislation, analysis by private sector & reports of international institutions (ADB, IEA, OECD, WB, EBRD, OECD, UNCTAD and others)

Investment Climate Indicators: ECT Principles

- Transparency (stable, favorable & transparent conditions) – Art. Of the ECT
- Rule of law and good governance
- Regulatory stability (Preamble) in the market structure and in the legal and regulatory regimes, competition (Art. 6 of the ECT) and energy pricing based on market costs (Art. 19 of the ECT)

Market structure indicators

- Market liberalization & competitive pricing
- Ownership & privatization
- Independent energy regulator
- Network management & Third Party Access (TPA)
- Industry Integration & unbundling

Azerbaijan (1998-2010)

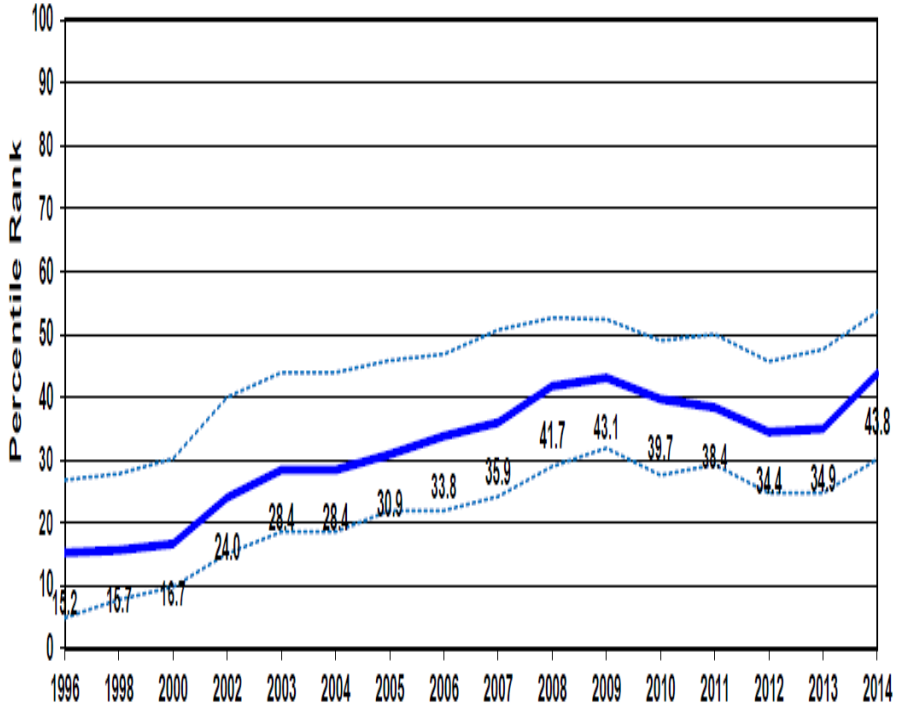
- Political commitment to the 'open door' policy to foreign investors in the oil & gas sector.
- Provisions of the ECT influenced energy-related legislation (Antitrust Law, 1993; Law on Investment Activity, 1995, Law on Utilization Energy resources, 1996, etc.)
- Improved indicators (rule of law, transparency, etc.)
- International dimension: Baku-Supsa (IGA, 1996), BTC (IGA, 1999), South Caucasus Pipeline (IGAs, 2001)
- Limited market liberalization
  - ✓ No independent regulator, no unbundling, TPA to be negotiated with SOCAR, limited TPA in the power sector
  - ✓ Limited market liberalization & privatization

Azerbaijan II (1998-2010)

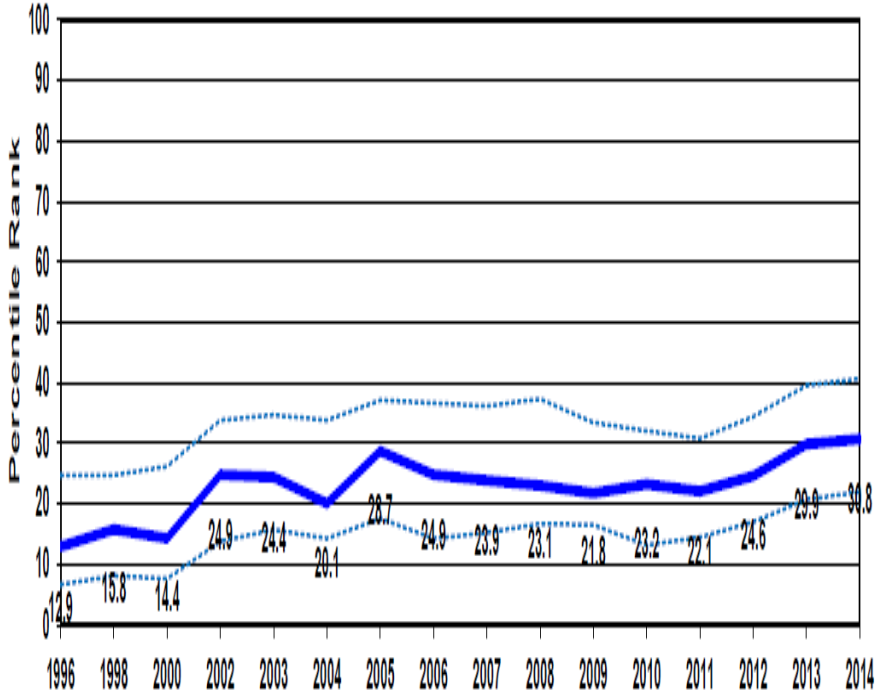
- 1991 – 2011: total investment in the energy sector - $96.3 billion (ECS ICMS Azerbaijan '11). FDI stocks grew from $0.33 billion (10.7% of GDP) in 1995 to $4.46 billion (17.6 % of GDP) in 2010 (UNCTAD '11)
- Oil production went up from 0.23 million b/d in 1998 to 1.035 million b/d in 2010 (BP data); gas output up from 5.2 bcma in 1998 to 15.1 bcma in 2000.
- Key projects:
  - ✓ Upstream: Azeri Chirag Guneshli (ACG) oil (1994) and Shah Deniz condensate fields (1999)
  - ✓ Infrastructure: Baku- Tbilisi –Ceylan (BTC, 1999), South Caucasus Pipeline (SCP, 2001), Baku – Supsa oil pipeline (1996).

Azerbaijan, World Governance Indicators (WGI), World Bank (1996 - 2014)

Regulatory quality



Rule of law

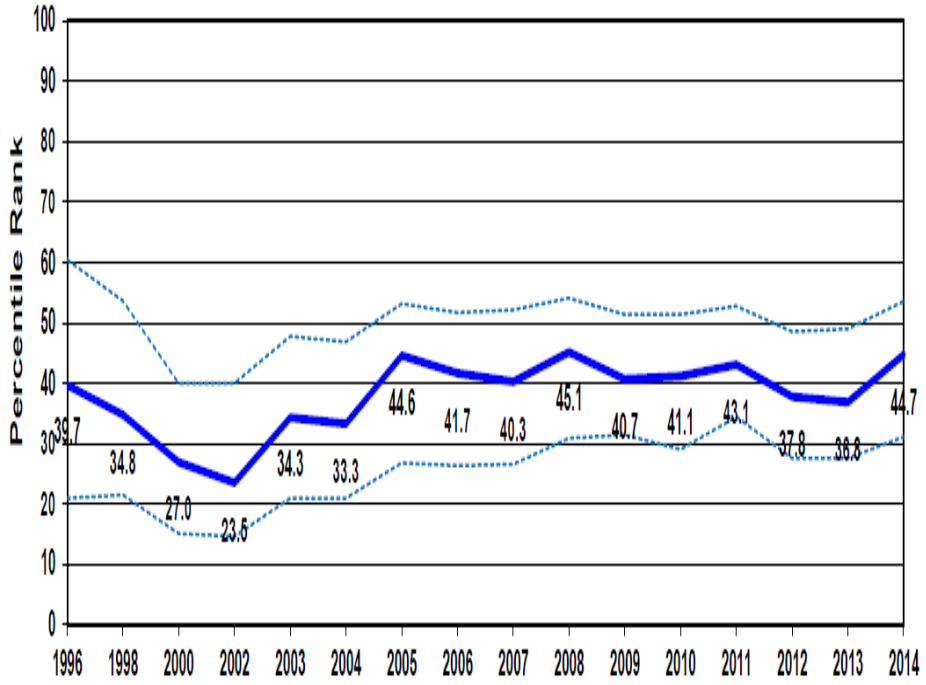


Kazakhstan (1998-2010)

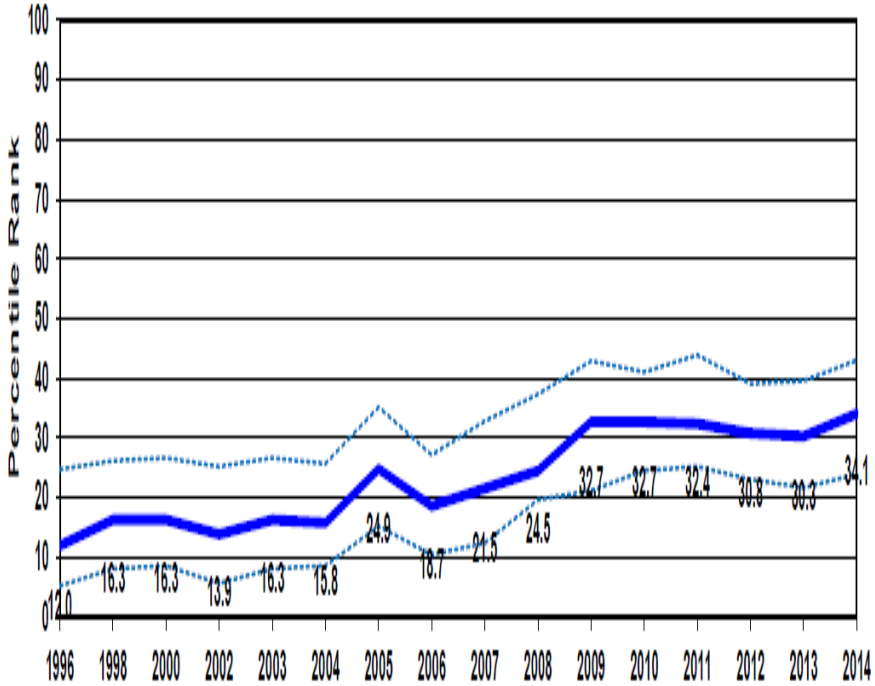
- Most advanced market design in Central Asia.
- Provisions of the ECT influenced energy-related legislation (ECT principles implemented in the law "On Power Industry", 1999)=>successful liberalization of the power sector.
- Improved indicators (rule of law, transparency, etc.)
- International dimension: the CACP (2006), etc.
- Market liberalization
  - ✓ Independent energy regulator
  - ✓ Electricity sector: TPA, unbundling. Operational unbundling & TPA (negotiated) in oil & gas sectors
  - ✓ Market liberalization & privatization (esp. in the power sector)

Kazakhstan, World Governance Indicators (WGI), World Bank (1996 - 2014)

Regulatory quality



Rule of law



Kazakhstan II (1998-2010)

- The FDI stocks increased from $2.895 billion (14.1 5 of GDP) in 1995 to $81.352 billion in 2010 (61.1 % of GDP) – UNCTAD '11.

- Oil production up from 0.537 million b/d in 1998 to 1.569 million b/d in 2010, gas output from 7. 4 bcma in 1998 up to 33.6 bcma in 2010, coal - up from 78,071 million tons in 1998 to 122,278 million tons in 2010 (BP).

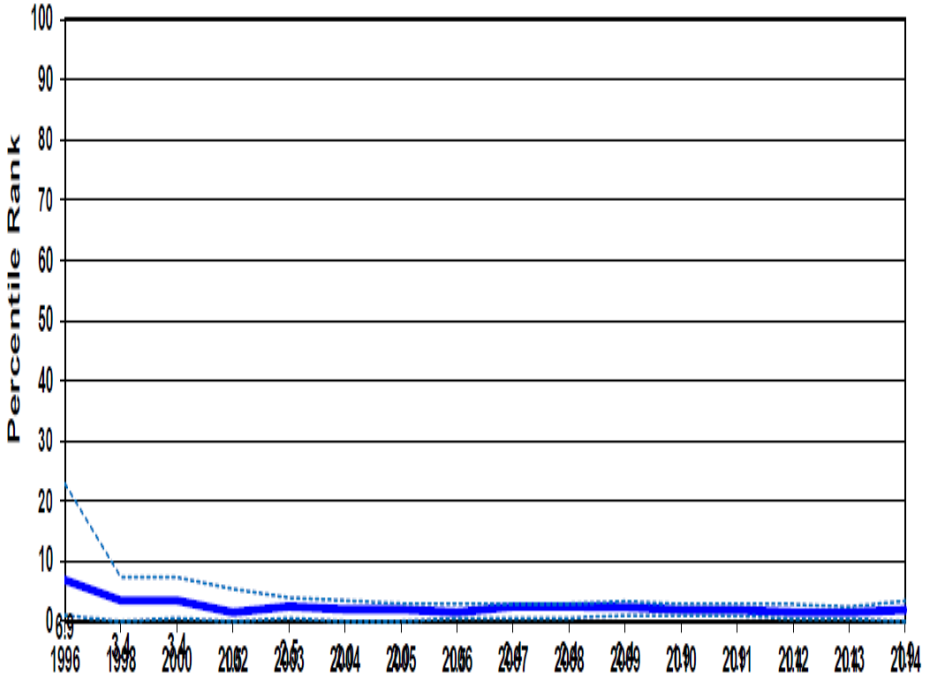
- Key projects:
  - ✓ Karachaganak Petroleum Operating (KPO), 1997.
  - ✓ North Caspian Operating Company (NCOC), 2000 (discovery of Kashagan)
  - ✓ Tengizchevroil (TCO), 1993.

Turkmenistan (1998-2010)

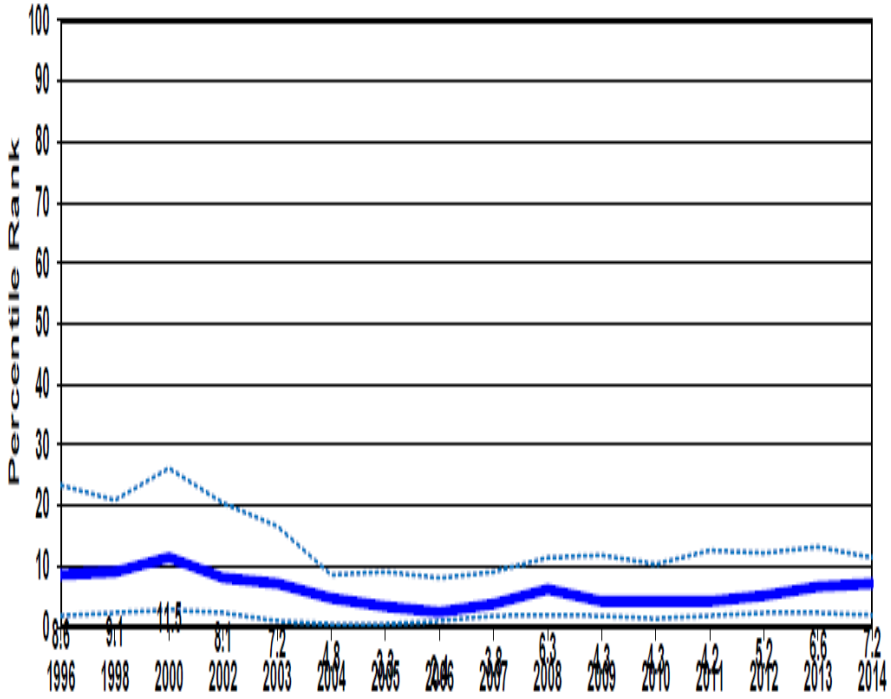
- Political commitment to PSA-based investment.
- Provisions of the ECT influenced the legislative process (more information is needed)
- The ECT are used by a foreign investor to gain additional protection ('Dragon Oil case')
- Some improvement in indicators (rule of law, transparency, etc.)
- International dimension: N/A
- Market liberalization:
  - ✓ No Independent energy regulator
  - ✓ No unbundling, limited TPA.
  - ✓ No market liberalization & privatization

Turkmenistan, World Governance Indicators (WGI), World Bank (1996 - 2014)

Regulatory quality



Rule of law



Turkmenistan II (1998-2010)

- FDI stocks up from $415 million (19 % of GDP) in 1995 to $8,186 billion in 2010 (40.7 % of GDP). FDI flows also went up from $179 million (1995-2004 annual average) to $2,083 billion in 2010 (UNCTAD '11)
- Gas output up from 12.4 bcma in 1998 to 42.4 bcma in 2010, oil production up from 0.129 million b/d in 1998 to 0.216 million b/d in 2010 (BP).
- Key projects:
  - ✓ Galkynysh
  - ✓ CNPC's Bagtyýarlyk PSA and the CACP
  - ✓ Dragon Oil Cheleken Contract area PSA; Petronas.

More in detail: Dragon Oil case

- Dragon Oil => PSA for the Cheleken Contract Area since 1999. Production level -100 kboe/d in 06/15 (more than 35 % of Turkmenistan's overall liquids production, 270 kboe/d in 01/16)
- Investment originating from non-Contracting Party (CP) - UAE - going to the CP (Turkmenistan) via an investment vehicle based in an another CP (Ireland).
- Turkmenistan – UAE BIT (1998), but no BIT with Ireland. Ireland's corporate tax is higher than in the UAE.
- Investor has used the ECT 'umbrella' to gain an additional investment protection.
- Problem: implementation of the Art. 17 of the ECT and denial of benefit.

Preliminary Findings

- The same starting point for theses Contracting Parties (CP), but uneven positive effect of the ECT accession.
- Commitment to reforms (Armenia, Georgia, Kazakhstan)=> comprehensive reforms of market structure;
- Azerbaijan => political will has led to massive FDI inflows;
- Kyrgyzstan, Tajikistan & Turkmenistan => more reforms needed.
- The ECT used as an additional 'safety net' in the CP by the non-CP investor.
- **The ECT is a "silver bullet" for the emerging economies in the process of restructuring their energy sectors and improving their investment climate.**

Thank you!
Any questions?

The ECS and the author kindly request the delegates to send their comments by 30th of May 2015.