The politics of petroleum and the Energy Charter Treaty as an effective investment regime

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Received July 1998; accepted January 1999

Abstract

The Energy Charter Treaty is assessed as an international regime for the promotion of investment in petroleum among participating states. Like any other international regime, the eventual effectiveness of this treaty will depend more on the convergence of interests of the parties than on legal niceties and enforcement. These parties include not only the signatory states but also state and private enterprises and subnational authorities. This analysis concludes that a high degree of convergence of interests exists among the signatory states, and this is underpinned by the need for transnational transport of petroleum. Set against this convergence is the undoubted divergence of interests in many states between the national governments on the one hand and companies and subnational authorities on the other. Political reform towards democracy will be needed for these conflicts of interests to be reconciled and for the Energy Charter Treaty regime to become fully effective. © 1999 Elsevier Science Inc. All rights reserved.

Keywords: Petroleum; Energy Charter Treaty; Investment regime

1. Introduction

The Energy Charter Treaty was originally envisaged as a vehicle to promote the flow of “western” investment and technology into the energy sector of the “eastern” transition states of the former Soviet Communist bloc and the flow of energy from the east to the west (Papaioannou, 1995). From the time of the signing of the original European Energy Charter in 1991, negotiations for the Treaty itself involved more than 50 countries over a period of 3 years. The Treaty was signed in December 1994 by 49 countries and the European Union. It has now been ratified by the required
30 states and came into effect on April 16, 1998. Negotiations for a Supplementary Treaty were concluded in December 1997.

This paper sets aside the legal arguments concerning the potential effectiveness of the Treaty (for example papers, see Waelde, 1996a) and concentrates on the wider political issues, particularly those concerning petroleum. Petroleum in both its main forms, oil and gas, is highly transportable compared to both coal and electricity. This, together with the key role petroleum products play in economic development, has resulted in the emergence of a truly international market in crude oil and oil products, and in growing regional markets in natural gas. Events in the Middle East and more recently in central Asia continue to show that petroleum is a commodity that attracts a high degree of political interest. Thus, any broad assessment of the likely effectiveness of the Energy Charter Treaty in the field of petroleum has to take into account the politics of petroleum both within and outside the group of Treaty signatory states.

This paper addresses two questions concerning the possible effectiveness of the Treaty in the field of petroleum investment:

1. What is the likelihood that the objectives of the Treaty will be achieved?
2. Would the effectiveness of the Treaty be enhanced by enlarging the membership?

The paper first examines the likely significance of the Energy Charter Treaty in international relations, and specifically focuses on the possible role of the Treaty as an international regime. This sets the scene for an analysis of the interdependencies and tensions between the signatory states and of the interests of non-signatory states.

2. The Energy Charter Treaty as an international regime

This is not the place for a detailed theoretical analysis of the role of treaties and international organizations in international law. However, it is necessary to review briefly the relevant schools of thought in order to provide a framework for an assessment of the likely impact of the Energy Charter Treaty.

Three major theories of the behavior of nations and the role of international organizations may be identified (Slaughter-Burley, 1993): Realist, Institutionalist, and Liberal. The Realist school believes that power lies at the root of the behavior of states, and that international law and international organizations play only a minor role (e.g., Morgenthau & Thompson, 1985). The Institutionalists argue that international law has a significant impact on states, through the creation of international regimes and institutions (e.g., Keohane, 1983). The Liberal school adds a further dimension to the debate by identifying domestic society as the source of state power and by arguing that state behavior depends on the configuration of preferences amongst interdependent states (Moravcsik, 1997). Thus, state policy depends on what segments of society the government represents, and the power that the state can exert on the international stage is tempered by institutional practices (Slaughter-Burley, 1993).

This analysis recognizes the utility of the Institutionalist approach and draws heavily on the premise that the Energy Charter Treaty is an international regime. At the
same time, the need to take into account the arguments of the Liberal and Realist schools is recognized.

2.1. Character of an international regime

An international regime is an institution designed by states that share certain common interests to constrain and order the behavior of these and possibly other states so that these interests may be realized (Ruggie, 1983; Puchala & Hopkins, 1983). Such regimes may appear spontaneously, may be the result of prolonged negotiation, or may be imposed by a minority of states (Young, 1983). A regime may be formal or informal in nature and may be directed at a single issue or a range of issues (Puchala & Hopkins, 1983).

The main components of an international regime are the principles forming the basis of the regime, the defined rights and obligations of the member states, the rules that prescribe or proscribe action, and the procedures for making decisions (Krasner, 1983). The actors in a regime, as in all international politics, are likely to include states, corporations, individuals, and international organizations (Wolfers, 1962).

Beyond the general aim of providing a framework for achieving common interests mentioned above, more specific objectives may be identified. A regime can provide a long-term framework for drawing up short-term agreements. This is especially valuable if the existing institutions are weak and cause high transactions costs to be incurred (Keohane, 1983). The setting of norms and the encouragement or legitimization of certain practices or activities are core tasks for many regimes (Abbott & Snidal, 1998). At a more fundamental level, an effective regime may create a climate of trust that was not present beforehand (Stein, 1983; Rengger, 1997). Indeed, the ongoing process of communication and collaboration forms an integral and important part of most international agreements (McDougal et al, 1994).

The strength of an international regime depends on the continued coherence of its component principles, rules, and procedures and on consistency between the actions of the participants and these components (Krasner, 1983; Frank, 1990). The nature of a regime may change in response either to shifts in underlying power structure among the participants or as a result of external factors (Young, 1983). Regardless of whether most nations respect the need for international law (Henkin, 1979) or whether national interest always takes precedence over international law (Morgenthau & Thompson, 1985), sustained compliance within a regime is likely to depend more on convergent self-interest of the parties than on enforcement (Puchala & Hopkins, 1983). The pursuit of self-interest may lead to compromise and concessions by some or all the parties involved if the result is an improvement in collective welfare (Moravcsik, 1997). However, a treaty or international regime is unlikely to survive if a majority or an influential minority reject it (Henkin, 1979).

2.2. The Energy Charter Treaty as an international regime

The Energy Charter Treaty fulfills a number of the criteria outlined above for an international regime. It is intended to provide a long-term framework for investment
and trade in energy amongst the participating states, as encapsulated in Article 2 of the Treaty. The focus is on a single issue, energy, and the Treaty came into being through negotiation. The document of the Treaty defines its purpose and scope, provides rules and standards of behavior to govern energy investment and trade, and sets up procedures for the arbitration of disputes and for implementing transition arrangements (for systematic accounts of the Treaty, see Waelde, 1995; Andrews-Speed & Waelde, 1996; Bamberger, 1996).

The official actors in this regime are the signatory states, amongst which is one transnational institution—the European Union. However, in reality the players will include state and private sector companies and a range of state institutions. The domestic societies of the signatory states are also actors, for energy is a crucial commodity in modern societies. All 30 ratifications made by January 1998 are either from Europe or the former Soviet Union. Indeed, of the original 50 signatory states, only Australia and Japan came from outside this region.

The common interest that will bind these states to compliance with the Treaty is the importance of energy in their national economies. The countries of the West are interested in obtaining supplies of petroleum from the eastern countries, preferably through the participation of their own companies, and the eastern states need investment and technology from the West to effectively develop their petroleum resources and require markets into which to sell their petroleum. For both sides to be satisfied, an enhanced degree of freedom of movement is required for capital, technology, and energy products. A final component of the Treaty concerns transit rights for pipelines, for without these investors, importers and exporters can gain little.

In addition to the strength of these common interests, the success of the Energy Charter Treaty as an international regime depends to a certain extent on the internal consistency of the various components of the regime: the objectives, rights, obligations, rules, and procedures. Different aspects of such matters have already been addressed by a wide variety of commentators (e.g., Waelde, 1996a). Despite a number of legalistic weaknesses in the text of itself, the Treaty has been welcomed because of the process of discussion and negotiation catalyzed domestic reforms in some of the transition states (Konoplyanik, 1996; Suleimenov & Holland, 1996).

3. The main elements of the treaty relating to petroleum investment

The purpose of the Energy Charter Treaty is to establish a “legal framework in order to promote long-term cooperation in the energy field, based on complementarities and mutual benefits, in accordance with the principles of the Charter” (Energy Charter Treaty, Part I, Article 2). The original European Energy Charter, signed in 1991, established a wide range of objectives within this overall framework. These included the enhancement—“on an acceptable economic basis”—of security of energy supply and of the efficiency of the entire energy industry from upstream to downstream. Two aims of greatest relevance to this paper were to “promote the development of an efficient energy market throughout Europe” and to “create a climate favorable to the operation of enterprise and to the flow of investments and technologies by

Though the name of the Treaty implies a wide application to energy as a whole, the scale of the petroleum resources in the Soviet Union combined with the ease of transport of oil and gas has the result that the potential impact of the Treaty should be greatest in the field of petroleum rather than in coal or electrical power. Likewise, although the Treaty covers both trade (The Energy Charter Treaty, Part II, Articles 3–9) and investment (Part III, Articles 101–7), the main interest in the Treaty is with respect to the provisions for investment and for trade where they relate to investment; for example, Article 5 covering Trade-Related Investment Measures and Article 7 covering transit.

The principle provisions of the Treaty for the promotion and protection of petroleum investments may be addressed under the following headings: basic principles, the investment regime, the treatment and protection of investment, and related measures (Andrews-Speed & Waelde, 1996). These are briefly restated here to set the scene for the subsequent discussion.

The Definitions provide for the Treaty to cover a range of types of tangible and intangible investments in the petroleum industry, including exploration, production, transport, distribution, and sales (Article 1). The Treaty defines an investor as being a person having nationality or residence in a contracting state, or a company that is incorporated in a contracting state. Investors from a third state must have substantial business in a contracting state for an affiliate in that state to benefit from the terms of the Treaty.

The regime for the making of investments is probably one of the least satisfactory components of the original Treaty because it is hedged with numerous words such as “endeavor” and “encourage.” Despite this weakness, the thrust of the Treaty is to provide a non-discriminatory regime for investment in petroleum, either national or most-favored nation treatment, whichever is most favorable (Article 101). Disputes arising under this “pre-investment” regime may be submitted for arbitration by the signatory states, but not by the individuals or companies concerned (Article 27).

The provisions for the treatment and protection of investments are significantly more robust. Along with a requirement for fair and equitable treatment according to international law, the Treaty binds the contracting parties to honor all obligations agreed to with an investor from another contracting state. Expropriation by the state, when in the public interest, is not prohibited, although the Hull formula of prompt, adequate, and effective compensation is invoked (Articles 12 and 13). These provisions are underpinned by a radical procedure for resolving “post-investment” disputes (Article 26). Foreign investors, individuals, or companies in dispute with a contracting state concerning an existing investment may choose to submit the dispute for arbitration. The investor may choose which of the available arbitration procedures to pursue, with or without the agreement of the host state. These provisions apply only to failures to honor obligations on the part of a host contracting state. They do not apply to foreign investors that fail to fulfil their obligations. In such cases, the host state must rely on either national law or on the terms of the investment agreement.
Transit is one of the most important issues addressed by the Treaty, for without provisions for the transport of energy products across international boundaries, there can be little international investment and no international trade in petroleum. The Treaty obliges the parties to “take measures to facilitate” energy transit according to the “principles of freedom of transit” and in a non-discriminatory manner (Article 7). In the case of a dispute, the flow of energy materials or products must not be disrupted. One novel component of the Article on Transit is the obligation on the contracting states to “encourage relevant entities to cooperate” in the upgrade of existing transport infrastructure or in the construction of new infrastructure (Roggenkamp, 1996). A further innovation is the provision of a conciliation mechanism for transit disputes that is intended to be faster than the interstate arbitration procedure provided by Article 27, although this latter alternative is also available for the resolution of transit disputes (Waelde, 1996b). It is important to note that companies may not take a contracting state to arbitration over a transit dispute.

4. Dependencies and tensions between signatory states

This section evaluates the Energy Charter Treaty by addressing three questions:

- What is the extent of common interest or convergence of interests among the signatory states which may allow the objectives of the Treaty (in relation to petroleum investment) to be achieved?
- Which players are most likely to prove either disinterested or obstructive?
- What issues are likely to prove the most controversial?

Though investment forms the focus of this article, markets and transit are vital to successful investment in petroleum. Therefore, the interests of the parties with respect to all three of these parameters are examined.

The evaluation begins with the signatory states themselves. However, no attempt to assess the likely impact of the Treaty can be restricted to the states alone because a number of types of other players are involved, including a wide range of government and private sector entities, as well as individuals. This account pays particular attention to the interests of enterprises and subnational authorities, as these are commonly the most powerful players below state level.

4.1. The signatory states

Any analysis of the likely attitudes and behavior of 49 nations plus the European Union requires considerable simplification. This account deliberately concentrates only on those issues directly relating to petroleum investment, specifically the import and export of petroleum, the import and export of capital and technology, and the requirement for transit. A further simplification is that most countries are not considered in isolation but have been clustered into groups with broadly similar interests with respect to petroleum.

Fig. 1 shows how the signatory states and neighboring regions have been grouped for the purposes of this paper. The significance and basis for this grouping is illuminated
by Fig. 2, which shows how these groups may be classified with respect to both petroleum trade and flow of capital and technology. Russia and the southern republics of the former Soviet Union (SFSU) are net exporters of petroleum and importers of capital and technology. Northwest Europe, specifically the United Kingdom, Norway, and the Netherlands, are net exporters of petroleum, technology, and capital. Japan and the rest of western Europe import petroleum but export capital and technology, while central and eastern Europe import all three.

Thus, in the context of the Treaty, there appears to be a relationship of interdependency between Russia and the SFSU on one hand and Japan and western Europe on the other. Though heavily dependent on U.S. capital and technology in the past, northwest Europe may now be considered a net exporter of petroleum, capital, and technology, though clearly it requires markets. Central and eastern Europe would seem to be in the unenviable position of total dependency.

This picture is incomplete because the issue of transit has not been taken into account. Fig. 3 shows the relative dependencies with respect to transit. It addresses two issues: Does the group of states form a transit route for one or more other
signatory states? and does the group require transit across other signatory states, for either exports or imports? The most significant segment of this diagram is the bottom right quadrant, which shows Russia, central and eastern Europe (CEE), and parts of western Europe (WEu (b) in Fig. 3) as both being transit states and relying on other signatory states for transit.

Russia provides northerly export routes to Europe for certain SFSU exporters, and yet relies on CEE states for transit to western Europe. The CEE states themselves and some western European states lie on transit routes from Russia to western Europe, and in turn rely on these transit routes for petroleum imports. The far western states of western Europe (WEu (a) in Fig. 3), which lie at the end of the pipeline network from Russia, rely on transit but do not provide it. Northwest Europe and Japan neither rely on nor provide transit. The SFSU states fall into two categories. Those with little or no petroleum resource, such as Armenia and Georgia (SFSU (b) in Fig. 3), are vital transit countries and yet can purchase their petroleum imports either from neighboring signatory states or from outside the Treaty regime. The remaining SFSU states of significance in this context are the major potential exporters: Kazakhstan, Azerbaijan,
Fig. 3. The significance of petroleum transit to the signatory states of the Energy Charter Treaty.

Uzbekistan, and Turkmenistan (SFSU (a) in Fig. 3). At present, a range of export routes are under consideration from these states. Depending on which are eventually chosen, some or all of the four exporters could fall into the category of both providing transit and requiring transit: requiring transit through Russia, Armenia, and Georgia, as well as through each other. However, they all have the option of choosing export routes to the south through Iran or, in some cases and more expensively, to the east through China.

On the basis of these considerations, a number of generalizations may be made concerning dependency and convergent interests. Those nations that would appear to have the most to gain from an effective Treaty regime are Russia, central and eastern Europe, and much of western Europe. An effective regional market for petroleum underpinned by a functional transit network is vital to satisfy their requirements for security of energy supply. This is of particular importance for natural gas. In addition, the transit fees form an important source of income for central and eastern European states.

At the other extreme, the petroleum exporters of northwest Europe would appear
to have nothing tangible in the petroleum sector to gain from the Treaty save for opportunities to invest capital and sell equipment and services. Their geographical position means that they have a wide range of markets for their petroleum exports.

The petroleum exporting states of the SFSU stand to benefit from the implementation of investment provisions of the Treaty in order to attract much needed capital and technology. Their dependence on the transit provisions is not as great because of the range of export routes open to them. Both these exporting states and western investors would benefit from the adherence to the transit provisions of the Treaty by Armenia and Georgia. They, in turn, stand to gain from the transit tariffs. Whether the Energy Charter Treaty will prove to be instrumental in solving the numerous transit disputes is a valid question. A possible framework for effective resolution might be a regional central Asian agreement or organization, rather than the larger, more nebulous Energy Charter Treaty (Carver, 1995).

At the geographical extremities of the Treaty region lie Japan and coastal western Europe. While Japan would prefer to diversify its sources of petroleum imports by tapping into the resources of Russia and the SFSU, this is far from being a requisite for its economic growth because its geographical position gives it a wide range of import options. The same argument may be applied to coastal western Europe.

At the level of the state, two controversial issues are control over natural resources and transit rights. Eastern states, especially Russia, are determined to prevent western states and companies from gaining excessive influence over their natural resources (Axelrod, 1996). Though this concern is to some extent fed by the interests of domestic companies and subnational authorities (see below), it is also present at the national government level. Indeed, it can be argued that the Energy Charter Treaty is premised on Europe’s requirement for security of energy supply and consequent need to gain access to the resources of the Commonwealth of Independent States (C.I.S.) (Papaioannou, 1995). This may, in part, explain Russia’s slowness to ratify the Treaty. Russia’s need for foreign investment, technology, and reliable export routes (Dorian & Khartukov, 1996; Miyamoto, 1997) and the potential for Russian companies to invoke the Treaty to protect their overseas investments in signatory states (Andrews-Speed, 1996) would seem to be overwhelming arguments for its adherence to the Treaty. Set against this are a number of considerations that might lead Russia to conclude that, in the narrow context of petroleum, it does not need the Treaty: Russia’s petroleum industry is, at last, attracting the interest of the large multinationals; the interdependence between Russia and western Europe for petroleum trade grew up without the Treaty and can continue without it; Russia may still hold sufficient political clout over its neighbors in eastern Europe to enforce its transit requirements, not least because they too need the petroleum from the pipelines; and Russia lies across a key export route from central Asia to Europe.

Russia aside, the states upon which the Treaty is most dependent are those upon which other signatory states rely for transit. Where a trade regime is dependent on a single pipeline or network of pipelines, the transit states are in a position of great power, which they are likely to use to their advantage, even if that state also consumes the petroleum in the pipeline (Stevens, 1998). This strength may be tempered if the
transit state is dependent on other signatory states, for example for foreign investment or strategic security. It is in the interests of both exporters and importers to construct multiple export routes that have an aggregate capacity greater than the production capacity (Stevens, 1998). The FSU states are evidently in a position to achieve this with potential routes to the north through Russia, to the west to the Mediterranean, to the south to Iran, and to the east to China. Of the two transit states to the west of the Caspian Sea, Georgia has ratified the Treaty—indeed it was the first country to do so. It lies on one of the favored routes for new petroleum pipelines west from central Asia, passing through Georgia to Turkey, and so to the Mediterranean. The other transit state, Armenia, has yet to ratify.

In contrast, the major export routes westwards from Russia depend almost entirely on passage across the Ukraine, although the new Yamal pipeline will pass through Belarus and Poland (Stern, 1995). In this respect, the Ukraine is in a relatively strong position to exploit its position as a transit state for economic or political purposes (Luciani, 1997), at least for the time being. In this respect it is significant that Ukraine has yet to ratify the Treaty, as have Belarus and Poland.

4.2. State and private enterprises

Governments may be concerned with security of energy supply, foreign exchange earnings, and the flow of investment, but it is the energy enterprises themselves that actually develop, transport, and sell the energy. They have considerable power to facilitate or obstruct the implementation of the Energy Charter Treaty, with or without the connivance of governments. The Treaty recognizes this and allocates to the State responsibility for adherence to the terms of the Treaty by “state and privileged enterprises” (Article 22) (Waelde & Wouters, 1996).

The heart of the strategy of any petroleum company, whether state or private, is to gain access to profitable investment opportunities, either upstream or downstream, and to gain access to energy transportation infrastructure. Conversely, any company that has a privileged national or local status will seek to defend its position. The most powerful of such privileged entities are those that own and operate transportation infrastructure because in the absence of an effective regulatory regime, they can deny access to the infrastructure by other companies. Most signatory states, even those in western Europe, have either given or allowed some of their energy companies to attain a privileged status: for example, Electricité de France, ENEL of Italy, RuhrGas of Germany, Gazprom and Transneft of Russia, MOL of Hungary, and Rompetrol of Romania. Whether fully or partially privatized or wholly state owned, each will continue to use political and economic means to defend its access to resources, transportation, and markets on its “home” territory. The Energy Charter Treaty unambiguously gives the home state the responsibility of preventing this behavior (Waelde & Wouters, 1996). At the same time, these enterprises are now in the position to invoke the terms of the Treaty to gain access to opportunities and infrastructure in other signatory states. The Treaty is symmetrical, granting companies from the former Soviet Union fair treatment in Europe to the same extent as western companies are granted fair treatment in the FSU. Indeed the balance is tilted in favor of companies from
central and eastern Europe and the FSU. Not only are investment conditions less discriminatory and more transparent in the West, but no western nation has applied for transition arrangements under the Treaty.  

Restructuring and liberalization of national energy sectors is proceeding both within the European Union and in central and eastern Europe (Klom, 1996), and thus the power of the large energy companies at home is declining, albeit at varying speeds. In the SFSU, the state petroleum companies lack both the power and the incentive to block the implementation of the Treaty because of their need for foreign investment and technology and their dependence on long-distance export lines.

The petroleum companies of Russia are in quite a different position. Gazprom is the largest gas producer in the world and controls the gas transportation infrastructure in Russia. Transeft has a monopoly over crude oil pipelines. Lukoil is one of the world’s largest private producers of oil, and the recently failed attempt to create Yuksi (from the merger of Yukos and Sibneft) would have spawned the world’s third largest private producer of oil. Any large petroleum company will wield considerable power in its home territory, especially if the regulatory regime is weak. In Russia, this is exacerbated by the intimate links between major privatized industrial groups and the highest levels of government, which are no more evident than in the petroleum sector (von Hirschhausen & Engerer, 1998). Of the Russian companies to benefit from this environment, the strongest is Gazprom. In addition to producing about 95% of Russia’s gas and having rights to 67% of the nation’s gas reserves, Gazprom owns almost the entire gas transmission and distribution network in Russia (Vyakhirev, 1996). This monopoly power extends not just over Russia, but can be projected abroad. Gazprom is the sole exporter of gas from Russia to Europe, and this has allowed the company to build significant investments in western and eastern Europe, for example Germany, Bulgaria, and Greece. Similarly, its control over export lines north from central Asia has allowed Gazprom to force its way into gas projects in this region. The nature of the oil industry and the number of Russian oil companies has, to date, prevented any one Russian company exerting such power over national and regional oil sector. However, the government’s apparent preference for giant corporations, witnessed by the failed attempt to create Yuksi, would seem to indicate that the power of Russia’s oil companies is set to increase, at home and abroad.

The privileged status of Russia’s petroleum companies combined with the persistent inadequacy of the investment regime have successfully deterred most foreign companies from investing in Russia’s petroleum sector. Of the few active projects, most are in the form of joint ventures and have been held hostage by unpredictable changes in legal and tax regimes (Slade & Chung, 1998). The recent acquisition by Shell and BP of shares in Gazprom and Sidanko, respectively, may mark the start of a new era and a new style of cooperation. However, the relationship between government and industry in Russia will ensure that even these initiatives will not be free from political interference nor from the incumbent Russian company’s ability to exert its privileged authority.

4.3. Subnational authorities

Many different types of government agency may have the power to influence the development of the energy sector. Central government aside, none have the potential
to acquire and maintain so much power as subnational authorities in federal regimes. Regional or provincial governments may possess de jure or de facto power to regulate access to natural resources and to transport infrastructure, power to set taxes and prices, and possibly partial ownership of energy enterprises. For this reason, the Energy Charter Treaty includes Article 23, entitled “Observance by Subnational Authorities.” In line with customary international law, the Treaty places the responsibility for observance by subnational authorities with the central governments of the signatory states. Central government has to rectify any discrimination against foreign investors displayed by subnational governments or pay the damages that arise (Waelde & Wouters, 1996). These provisions were not included without controversy and provided one of the reasons for the United States’ failure to sign the Treaty (Dore, 1996).

The power base of subnational governments is likely to dictate that their interests do not necessarily coincide with either those of central government or those of domestic energy companies. Control over resources, high employment, and tax revenue are probably their highest priorities. Central governments in many federal regimes find it difficult to enforce enlightened foreign investment policies on unwilling provincial governments, and even domestic energy companies may face punitive taxation or regulation.

Though a number of signatory states have federal forms of government, Russia is the country where this is most threatening to the Treaty. The sheer physical size of Russia, along with its ethnic diversity, will encourage local governments to act with a high degree of autonomy. In the context of foreign investment in the petroleum industry, this might be expected to result in a high degree of discrimination against foreign companies. On the other hand, the more progressive authorities may realize that they have much to gain by playing off the foreign and domestic companies against each other.

5. Interests of nonsignatory states

In terms of the global setting of the Energy Charter Treaty, it is important to identify those states whose interests may be threatened by the Treaty and those who might benefit from joining the regime. Fig. 1 shows that the signatory states form a physically coherent block and that nonsignatory states lie outside this block to the west (as drawn) and south. The same logic as before has been used to plot the regional groups of states onto the four quadrants of dependency in Fig. 2. The U.S. joins western Europe and Japan as a net importer of energy and an exporter of capital and technology. South and east Asia, together with eastern and southern Africa, are net importers of petroleum, capital, and technology. Only Canada joins northwest Europe in the “self-sufficient” quadrant. The Middle East, North and West Africa, and Latin America are all petroleum-exporting that which are net importers of capital and technology. With some exceptions, which will be addressed below, long-distance overland pipeline transit is not an issue and so a transit matrix like Fig. 3 has not been drawn for the non-signatory states.

One of the most significant developments in the global petroleum markets in recent
years, and one which is not shown in Fig. 2, is the emergence of regional markets (Odell, 1997). This has resulted from a gradual shift of interdependencies in the trade of petroleum (Table 1).

As North America’s reliance on Latin America for petroleum imports grows, so does the significance of this “western hemisphere” regional market. At the same time, the dependence of both North America and western Europe on the Middle East is declining. An increasing proportion of the Middle East’s exports is destined for south and east Asia (Mitchell, 1996), which is itself evolving into a regional petroleum market as its economies grow and less petroleum is available for export. Russia’s re-emergence as a major net exporter of petroleum combined with the export potential of central Asia will form the basis of Odell’s third regional market, which encompasses Europe and the former Soviet Union, as well as North Africa. This leaves the Middle East and West Africa as residual suppliers.

Two groups of nations might have a direct interest in seeking to join the Energy Charter Treaty regime: those Mediterranean states that have not already signed, and the energy-importing states of northeast Asia. Because it lies on a major export route from central Asia, Turkey is the most strategically important Mediterranean state outside western Europe to sign the Treaty to date. The U.S. government as well as western investors are keen to promote the construction of oil and gas pipelines from the Caspian region across Turkey to the Mediterranean (Quinlan, 1998). To the south, Algeria, Libya, and to a lesser extent Egypt are significant exporters of petroleum. In 1996, some 75% of the oil and more than 90% of the gas exports from North Africa were destined for signatory states in Europe (British Petroleum, 1997). In addition, Tunisia is a transit state for the Algerian gas export line. As the European Union’s gas markets are liberalized and as the level of gas exports from Russia rises (Stern, 1995), the gas-exporting states of North Africa may find their share of the European market under attack. Membership of the Treaty regime should allow them to receive fair market access. Direct benefits in the field of petroleum for non-exporting states in the southern and eastern Mediterranean are rather less easy to identify. However, as the European Union seeks closer engagement with the Mediterranean region, cooperation in the energy sector is likely to grow.

The petroleum-importing states of northeast Asia, like those of Europe, wish to
gain access to the FSU’s petroleum resources. Only Japan is a signatory state, but China, Mongolia, and South Korea are all in discussion with the Treaty Secretariat (Vlaanderen, 1998). The gas and oil reserves of eastern Siberia can, realistically, only be exported to the south and east to northeast Asia. These states also have their eye on central Asia, especially the gas resources. The regulatory issues for these eastern export routes are likely to be similar to those for the western routes; with the proviso that the gas markets in the east are less liberalized than those in Europe. Rather than creating an entirely new regime for east Asia, the participation of these northeast Asian states in the Energy Charter Treaty may be to the benefit of all parties, including the western oil companies involved.

Of the other non-signatory states, the most significant are the U.S. and the Middle East oil-exporting nations. The U.S. was a party to the European Energy Charter and took part in the negotiations for the Treaty, but it declined to sign. The reasons included a belief that the Treaty was not necessary, the conflict with MFN legislation, and objections from the states themselves, especially concerning taxation (Axelrod, 1996; Luciani, 1997). Regardless of the reasons, the question remains: Does the absence of the U.S. effect the viability of the Energy Charter Treaty? In the light of the regionalization of global petroleum markets, a simple answer might be that the absence of the U.S. is of little consequence. Two reservations must be highlighted. First, U.S. companies are major investors and suppliers in the petroleum industry of the FSU. Second, persistent involvement of the U.S. in Gulf politics demonstrates that the physical security of large petroleum resources are of national concern to the U.S., wherever they are located. The threat to the Energy Charter Treaty is unlikely to come from a deliberate attempt by the U.S. to undermine it; rather, the U.S.’s attempts to promote its own economic, energy, and political interests in the area may be pursued without coordination with the Treaty regime. At the very least, this may lead to a confusion of messages emanating from investing states (for example, see Luciani, 1997).

The failure to involve the petroleum exporting states of the Gulf in the Treaty negotiations is of interest, given that security of energy supply was the driving force behind the western European initiative. In many respects, this omission is understandable: 60% of Middle Eastern oil exports now go to south and east Asia, up from 45% in 1990; at the same time, western Europe’s share has fallen from nearly 30% to 20% (British Petroleum, 1991, 1997); and the power of OPEC has declined dramatically as has the level of international oil prices. Also, the involvement of such a distinct group of nations would almost certainly have slowed Treaty negotiations significantly. In the long term, is it wise for the Treaty regime to ignore a region that possesses 65% of the world’s proven reserves of oil and 32% of the reserves of gas? This compares with the FSU, which holds 6% of the world’s proven reserves of oil and 40% of the gas reserves (British Petroleum, 1997).

Given that a diversity of sources is the key to long-term security of energy supply, Europe has no option but to maintain a working relationship with the Middle Eastern oil exporters. With the present oversupply of oil production capacity, the Middle East’s need for markets is sufficient to guarantee Europe access to its oil production in a global market. Ongoing exploration, especially in central Asia, will almost definitely
enhance the FSU reserves significantly, but the Middle East remains the world’s long-term “bank” for petroleum. Gas, rather than oil, is likely to be the factor that draws Middle Eastern states to the Treaty regime; for example, they need access to markets once they start to develop their gas reserves systematically. However, they will be unwilling to join unless the Treaty regime has achieved a track record of successful implementation.

6. Conclusions

The success of the Energy Charter Treaty in achieving its objectives in the field of petroleum investment depends less on its quality as a legal document and more on the degree of convergence of interests of the signatory states and, to a lesser extent, on non-signatory states. This article adheres to the Institutionalist view that international regimes have a role to play in international politics, but it also recognizes that powerful players are in a position to ignore or disrupt a treaty regime.

This account has shown that a high degree of convergence of interests exists among most of the signatory states, with respect to the development of petroleum resources and to the transport and sale of petroleum products. Of these three activities it is the need for energy transit that provides the greatest potential for enhanced interdependence. Signatory states that would appear to have the most to gain from the regime include most of petroleum-importing Europe, especially central and eastern Europe, and many exporting states of the FSU, including Russia. The potential impact of the Energy Charter Treaty is much greater for natural gas than for oil because of the transport requirements for gas and the consequent nature of the market. Those states that have less to gain are those at the physical extremities of the Treaty block and have access to other markets, either for export or for import, northwest Europe and Japan, for example.

The potential for this apparent convergence of interest to lead to successful implementation of the Treaty in the field of petroleum investment is tempered by a wide range of factors. Nationalist sentiment and resentment of foreign investors may prevail at central or local government levels. This may be reinforced by close links between domestic petroleum companies and government. Governments may be unwilling or unable to prevent abuse of monopoly powers or discrimination against foreign investors. In this context, the failure of Russia to ratify the Treaty would be disturbing.

The Liberal view of international politics holds that governments represent particular segments of domestic society and that their behavior will thus depend on which segments of society they represent. The transition states of Europe and the FSU are currently in a state of political flux, and the direction and speed of evolution of representative government is neither consistent nor uniform. The Liberal school argues that a higher degree of democracy tends to lead to a higher degree of cooperation among states (Moravcsik, 1997). This view ignores deep-rooted differences between the societies and institutions of mature democracies and those of the post-Soviet nations (Waelde & von Hirchhausen, 1999). Even with universal suffrage, it may take many years before the motivation, understanding, and behavior of former Communist
societies resembles those of western Europe. Both the desire for and the conditions for interdependence in the field of petroleum investment may take many years to emerge. Indeed, even the countries of the European Union have experienced great difficulty in implementing their internal market for energy. How much more difficult will it be for the 50 signatories the Energy Charter Treaty?

That is far from saying that the Treaty has no value. Many of its terms relating to petroleum investments, transit, and markets may be successfully implemented in a number of locations, either through formal integration into national legislation or by more ad hoc arrangements. But a seamless market for petroleum capital and products is a long way off. Despite this, companies will take the risk of investing, and many will be successful.

A number of non-signatory states that abut the Treaty regime block are likely to see advantages in either joining the regime or setting up regional equivalents. These include the Mediterranean states and the petroleum-importing nations of northeast Asia. Given the present regional nature of markets for both oil and gas, such an enlargement (albeit through association agreement) would seem to be consistent with the underlying logic of the Treaty. Whether it enhances the effectiveness of the Treaty will again depend on the nature and speed of political and social reform in the countries that join the Treaty regime.

Notes

1. These provisions were intended to be strengthened by the Supplementary Treaty.
2. Part VI of the Treaty provides for temporary exemptions from a range of Treaty provisions, mainly those covering anti-competitive behavior and transparency. Nearly every signatory state in Central and Eastern Europe and the Commonwealth of Independent States has claimed the right to some of these exemptions.
3. It should be noted that Articles 38 and 41 of the Energy Charter Treaty restrict accession to those states which signed the original European Energy Charter. However, Article 43 provides for association agreements with states or regional economic integration organizations “in order to pursue the objectives and principles of the Charter and the provisions of this Treaty.”

References


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