

CCEE POLICY BRIEF

May 2016 | No.26



NEW IMPETUS IN IRAN - AZERBAIJAN ENERGY RELATIONS? *

Background

Since 2013, Iranian-Azerbaijani relations have been improving. This general tendency was consolidated with the signing of 11 new bilateral agreements during an official visit of President Ilham Aliyev to Iran on 23 February 2016. After the visit, the media focused caught on the deal on the implementation of the North-South transport route.

However, the visit was also crucial in terms of strengthening bilateral energy relations. The agreements and memorandums for cooperation signed in the field of energy have created hope that the cooperation in this important sector is entering a new chapter.

Analysis

There are currently five key energy-related areas in which Iran and Azerbaijan are both ready to boost cooperation.

Joint exploitation of the Caspian Sea fields

There is no formal agreement yet on how to implement joint exploitation of the Caspian oil and gas fields, but

insiders reveal that this was the most essential among the topics discussed during Ilham Aliyev's February visit.

In regard to bilateral energy relations, the most relevant field is Araz-Alov-Sharg, which is allegedly located at the same area as Iran's Alborz oil field. Iran considers Araz-Alov-Sharg as part of its territory, because it lies within the one-fifth of the Caspian Sea that is claimed by Tehran. The hydrocarbon deposit, which is mainly oil, is located very close to the seabed that is called 'living oil'.

The estimates as to the amount of oil the block holds vary from 2bn to 5bn barrels. Although the PSA agreement was signed in 1998, it has lain dormant since 2001. In its 2006 sustainability report, BP stated that it "has no plans for on-site work in the Alov contract area until Caspian littoral states reach an agreement on offshore demarcation of the sea".

*Elmar Baghirov is a foreign policy expert based in Azerbaijan. His areas of expertise include the energy policy of Azerbaijan and the Black Sea-Caspian region energy security.

ISSN 2313-1233

9 772313 123004

In the absence of public details, one may conclude that the benign intention to collaborate is there, and that this in itself is a positive sign. If an agreement is reached, not only will tensions between the two in regard to the Caspian Sea dispute disappear, but also a new chapter in energy cooperation will begin. Moreover, Iran has invited SOCAR to invest in some of its fields in the Caspian Sea. The projects presented by Tehran will not cause any controversy on the Azerbaijani side, as they are all within the Iranian sector of the Caspian Sea.



The increasing clout of SOCAR Trading and oil swap deals

When it comes to the purchase of Iranian oil, the experience of SOCAR Trading (a subsidiary of State Oil Company of Azerbaijan) could be very helpful. However, the two memorandums signed with the National Iranian Oil Company (NIOC) and Ghadir Investment Company do not provide us with information on specific areas of cooperation; rather they simply depict the general contours of the map of cooperation between SOCAR and the Iranian companies.

Bearing in mind the fact that the attention of global energy giants is on Iran, one may assume that SOCAR is not the only company that is willing to play the role of a trader. However, it holds one advantage over its rivals. SOCAR Trading used to trade with the NIOC before the sanctions were imposed on Iran. Thus, we may expect a ‘reset’ of trade, and even a full speed acceleration, given Tehran’s thirst for oil revenues.

Oil swap deliveries offer another potential area of cooperation. Iran’s deputy Minister of Oil, Rokhnaddin Javadi, emphasized that after a five-year break Tehran has decided to resurrect oil swaps with Azerbaijan. Azerbaijan first signed an agreement with Iran back in 2008, when there was an explosion at the Turkish section of the BTC pipeline. Later the swap operation slowed due to the lack of extra oil coming out of Azerbaijan. Although the details have not yet been disclosed, Azerbaijan may benefit from diversifying its export routes. In the light of worsening relations between Turkey and Russia the possibility of another explosion of Baku-Tbilisi-Ceyhan pipeline should not be excluded.

New Electricity Corridor

One of the outcomes of the visit was the framework agreement on the sale of Azerbaijan's electric power to Iran. With the construction of the Mugan transmission line, Azerbaijan will be able to start selling its electricity to Iran within the next couple of months.

However, an even more important result of the negotiations was a tacit agreement to merge the electric lines of Iran, Azerbaijan and Russia, thus creating a North-South energy/electricity route in addition to the existing transportation route. In technical terms Azerbaijan is ready to connect its power system with those of Iran and Russia. By doing this Azerbaijan will be able not only to transport power, but also to export its power to both Russia and Iran, a key consideration given its domestic energy surplus glut. As a result of this agreement Azerbaijan will be able to diversify its power export routes. Thus, the North-South Power transmission line will be added to the existing electric energy networks which link Azerbaijan with Georgia and Turkey. At the same time, Azerbaijan will play a transit role in the route between Russia and Iran, thereby gaining additional dividends. There will also be possibilities for swapping power. The synchronization of the energy systems of Azerbaijan, Iran and Russia has been a topic of discussion for several years, and this issue is currently at the negotiating stage.

Khudafarin power plant

One of the energy agreements was related to the construction of Khudafarin hydropower plant. Due to the fact that the administrative buildings of the plant will be located in the occupied territories of Azerbaijan, the importance of the infrastructure increases drastically. Iran agreed to oversee the security of Azerbaijani specialists involved in the construction process. According to the agreement, after the restoration of its territorial integrity, Azerbaijan will take the lead on the administration of the power station. This will be Azerbaijan's first major project on the occupied territories. The agreement is now in the process of ratification.

Alternative energy sources

Another potential area of cooperation is renewable energy. There is an active discussion with the State Agency on Alternative and Renewable Energy Sources regarding the construction of geothermal and wind power plants in Iran's Meshkin Shahr and Khaf cities respectively. In fact, these discussions date back to 2015, when Azerbaijan and Iran created a working group with the aim of realizing joint projects in the sphere of alternative energy.

Other related issues

Along with the topics mentioned above, a number of other issues also arose at the negotiating table, including the transportation of Iranian hydrocarbons. The Baku-Tbilisi-Ceyhan pipeline has available capacity for the transportation of Iranian oil. The Southern Gas Corridor will be ready in the near future and thus able to deliver Iranian oil and gas to European markets. However, no deal has been signed so far. Moreover, given SOCAR's experience, one may expect its involvement in the upstream projects of Iran in the foreseeable future.

There is also a significant likelihood that Azerbaijan will become an important gas transit country between Russia and Iran. The recent agreements between Russian Gazprom and Iran over the purchase of Iranian gas in return of getting the same volumes Iranian gas from the Persian Gulf may render that possible.

Conclusion

Post-sanctions Iran is willing to turn a new page in its regional relationships, and the energy sector is a good starting point with countries like Azerbaijan. The latest visit of the Azerbaijani president to Iran has opened up an opportunity for the realization of those arrangements. Once realized, the agreements may change the scope of bilateral relations. Mutually beneficial projects in the energy sector will undoubtedly have a spillover effect on other spheres of cooperation.

Currently Iran is open to cooperation, because it is in desperate need of foreign investments. It is offering its oil fields to energy giants. Azerbaijan has the opportunity to enter this untapped market.

Caspian Center for Energy and Environment of ADA University welcomes submission of policy briefs by researchers and practitioners working on Caspian energy and environment issues. Policy Briefs are relatively short analytical papers (usually not exceeding 1400 words) focusing on causes and implications of energy and environment related trends in the wider Caspian region. Research should cover one of the hot topics on energy sector, mainly on the major technological, economic, social, political and regulatory trends influencing the energy and environmental issues in the Caspian basin and address a clear question with the pragmatic focus on current developments and prospects of the issue. Policy briefs are expected to provide well-explained and evidence-based arguments. Researcher should stay focus on the problem, and its important dimensions, and offer viable recommendations together with justifications.

By sticking to its primary goal on generating research-based information in the field of energy and environment, CCEE expects policy briefs to contribute to the process of advancing the understanding of readers in the field. Ethical and objective approach of the researcher is highly appreciated by CCEE.



Caspian Center for Energy and Environment

ADA University
Ahmadbay Aghaoghlu Street,11,
Baku, Azerbaijan, AZ1008

Tel : [+994 12] 437 3235 ext 307

Fax : [+994 12] 437 3236

E-mail : ccee@ada.edu.az

Web : www.ccee.ada.edu.az
www.ada.edu.az