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**Russian state-owned energy
companies' economic and political
incentives in Kurdistan Region of Iraq**

MA thesis

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I have written this Master's thesis independently. All viewpoints of other authors, literary sources and data from elsewhere used for writing this paper have been referenced.

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Abstract

Russian state-owned companies' have started engaging in the energy sector of Kurdistan Region of Iraq (KRI), an autonomous region in the north of Iraq, since 2012. Gazprom and particularly Rosneft have expanded their presence in the region despite the increasing economic uncertainties and political unrest. Considering the critical role that energy plays in the international political and world economy it becomes important to understand the main drivers and incentives behind Russian energy companies' expansion into KRI's energy sector.

This study employs Dunning's OLI Model, in order to understand the economic motives behind Gazprom and Rosneft's engagement in the energy projects in KRI. In addition, neomercantilism approach is combined with the home-country factors introduced by Kalman Kalotay in order to understand the Russian state's motives as an additional dimension of decision-making force behind the Russian companies' state-owned expansion into KRI's energy sector. The theoretical framework generates a set hypotheses, variables and related indicators which assisted with gathering data and analysis.

The findings demonstrate that Gazprom and Rosneft's economic motives for expansion into Kurdistan Region of Iraq's energy is mainly driven by natural resource-seeking motives. This motive could be explained with more details in case of Rosneft as: diversifying and securing supply of crude oil for downstream businesses in Germany and India. When taking into consideration the home country factors, Gazprom and Rosneft operation in Kurdistan Region of Iraq seems to serve the economic goals of the Russian state, in addition to serving the national security by accessing the strategic natural resources and transit routes in the Middle East.

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List of abbreviation

| | |
|----------------|--|
| bcm | Billion Cubic Meters |
| bpd | Barrels per day |
| EIA | Energy Information Administration |
| FDI | Foreign Direct Investment |
| GDP | Gross Domestic Product |
| IMF | International Monetary Fund |
| IPE | International Political Economy |
| ITP | Iraq Turkey Pipeline |
| KOGL | Kurdish Oil and Gaz Law |
| KRG | Kurdistan Regional Government |
| KRI | Kurdistan Region of Iraq |
| KROP | Kurdistan Region Oil Pipeline |
| LNG | Liquefied Natural Gas |
| mbpd | Million barrels per day |
| MNR | Ministry of Natural Resources |
| OECD | Organization for Economic Co-operation and Development |
| OFDI | Outward Foreign Direct Investment |
| OLI | Ownership-Location-Internalization advantages |
| OLIH | Ownership-Location-Internalization-home country advantages |
| OPEC | Organization of the Petroleum Exporting Countries |
| PSC | Production Sharing Contract |
| TSC | Technical Services Contract |
| UNCTAD | United Nations Conference on Trade and Development |
| (H) advantages | Home-country advantages |
| (O) advantages | Ownership-specific Advantages |

| | |
|-----------------|--|
| (Oa) advantages | Property rights and/or intangible asset advantages |
| (Ot) advantages | Common governance advantages |
| (Oi) advantages | Institutional assets |
| (I) advantages | Internalization-specific advantages |
| (L) advantages | Location-specific advantages |

Introduction

After the collapse of the Soviet Union in 1991, Russia has been experiencing a striking transition from a state-controlled and centrally planned economy to a market-oriented model. The economic and political transition brought about radical changes in the wealth and power composition of Russia internally and in face with the rest of the world. Russian national and international policies have been evolved from Yeltsin to Putin's presidency pursuing Moscow's domestic and global goals. The main pillars of Russia's economy, its domestic and global strategies and policies has been its energy sector. For this reason, Russian energy giants remained at the frontline of building up Russia's economy and its global position. In Russia's gradual process of integrating into the global political economy, there have been Russian companies which have showed a pattern of growing Outward Foreign Direct Investment (OFDI) in different parts of the world. Three decades after the collapse of the Soviet Union, in 2017, Russia has become the 12th largest capital exporter state, while ranking as the 14th largest capital importer in the world (UNCAD 2019, 4-7). With Russia's growing presence in the global market, scholars have paid special attention to the main determinants of the Russian companies' investment overseas. One strand of research understands the motives behind the Russian companies' investment abroad as purely economically motivated, while interests are defined at the firm level. The second strand of scholarship argues that Russian companies operate abroad with purpose of pursuing both economic and political interests defined at state level. Certain conditions were observed in which pursuing economic interests were overlapped the political ones or the other way around.

Russian OFDI has favored establishing economic ties through OFDI with former Soviet states and European countries. Middle East is a new dimension in the landscape of the Russian companies' expansion history. More importantly, Kurdistan Regional of Iraq (KRI) where some of the world's largest energy multinationals have established their presence since 2007. KRI, a region in the north of Iraq is a new energy player in the Middle East. KRI owes this new status to the political system change after the collapse of Saddam in 2003 and its recognition as an autonomous region in the Iraqi constitution in 2005. Russian state-owned companies showed interest in engaging in oil and gas projects in KRI since 2010 by sending representatives to the region and signing a series contracts starting from 2012. There has been no fall in showing interest in KRI's energy sector by

Russian companies despite the variety of economic and political uncertainties evolved thought time in the region.

The main objective of this thesis is explaining the economic and political incentives behind the Russian state-owned investment in the energy sector of Kurdistan of Iraq. Russian state-owned companies' expansion into KRI's energy sector is put in perspective in this thesis, as it is a new phenomenon not addressed in the academic works. There is no study highlighting the economic and political determinants of the Russian companies' expansion in KRI. Russian companies' growing presence in KRI constructs this thesis research question as:

“What are the main economic and political incentives behind the Russian state-owned energy companies' OFDI in KRI?”

Two main approaches guiding this thesis are OLI paradigm and Neomercantilism approach, from which hypotheses and variables are developed. Evidence from the secondary data was presented and contrasted with the expectations generated from the theories. The topic of capital outbound from Russia is relevant topic given the growing Russian companies' OFDI in different regions across of the world. This relevance could be seen from Russia's current position among the global OFDI contributors and trend that motives behind the companies' expansion goes beyond economic and commercial incentives and will follow Moscow's foreign policy. The second chapter

This thesis is constructed of three main chapters, starting with the theoretical framework. The first chapter is dedicated to building a theoretical understanding of determinants of Foreign Direct investment based on neomercantilism approach and OLI paradigm. This chapter assist with generating independent variables and hypotheses in relation to economic motives behind expansion into overseas markets, in addition to the role of home country in directing the investments. The second chapter provides an overview of the methodological approach employed for the purpose of this thesis. Chapter explains the method used for explanatory case study and qualitative analysis based on explanation building. The third chapter presents the data and analysis.

1. Theoretical framework

The first section starts with introducing the (O)wnership-(L)ocation- (I)nternalization (OLI) paradigm, developed by Dunning in 1988 as a framework capable of explaining the economic motives behind the companies' Foreign Direct Investment (FDI) and expansion overseas. Then the section continues with an overview of OLI paradigm's evolution in accordance with Russian state-owned companies, mainly drawing on Kalman Kalotay's arguments and his adjustments to Dunning's OLI paradigm. The main understanding taken from this section is that there are certain advantages needed to be met by the company and offered by the targeted host country for the investment to be concluded in the form of FDI or a contractual expansion. These advantages portray the main economic motives behind a company's FDI. Extra to these advantages, Russian state-owned companies are driven by certain home-country based factors which is well-explained by Kalman Kalotay's "home-country factors" which provides a tool for explaining how states influence and direct strategic companies' FDI. The second section of this chapter sheds more light on how a state like Russia interprets and structures its position against the economic and political composition of the world into its national strategies and policies. A position which ultimately leads the strategic companies' FDI. The main theoretical framework chosen for this purpose is neomercantilism.

1.1. OLI paradigm and economic determinants of foreign direct investment

FDI is the main term discussed in this thesis, which is largely based on the definition provided by the Organization for Economic Co-operation and Development (OECD). International Monetary Fund (IMF) and OECD are the two main international organizations which have provided definition and guidelines related to FDI. Typology and definition of FDI provided by both organizations is consistent (IMF 2009, xii). FDI is defined as a long-term relationship between two countries namely the 'home' and the 'host'. The home country channels the capital into the host country's economy from which both parties may enjoy exchanging technological knowledge and/or developing their industries and market share. Investor is referred to as the state or authorities of an enterprise who are in the position of power to make decisions. Within OECD's framework, Multinational companies are the main entities conducting direct investment (OECD 2008, 14). The investor has influence and control its investment (ibid, 24).

The dominant framework employed for explaining and analyzing the main drivers of the multinational companies' Outward Foreign Direct Investment (OFDI) is the eclectic paradigm or the so-called OLI paradigm. This paradigm provides answers to the questions of why, where and how companies decide to internationalize or expand overseas based on three main advantages categorized as: "Ownership-specific advantages", "Location-specific advantages" and "Internalization-specific advantages". The first, "ownership-specific advantages" explain "why" a firm decides to invest overseas, while "Location-specific advantages" is more concerned with answering the question related to where the investment is directed to. Lastly, "Internalization-specific advantages" draws the attention to the "how" the investment is planned and conducted by the management of the company (Dunning and Lundan 2008, 124).

Dunning provides three distinct forms of "Ownership-specific advantages": first, "property rights and/or intangible asset advantages" or "(Oa)"; second, "common governance" or "(Ot)"; third, "institutional assets" or "(Oi)" (Dunning 1988 via Dunning and Lundan 2008, 101). "(Oa)" advantages refer to companies' capabilities drawn from its intangible assets such as marketing experience, strong brand name and innovation capacities (Dunning and Lundan 2008, 101). "(Ot)" advantages are related to the firm's capabilities generated from its complementary assets. Such advantages rest on the firm's exclusive capabilities of sourcing services or production inputs, marketing or financing arrangements. Such capabilities are in a positive relation with the firm's size and its monopolistic or oligopolistic position in the national and international market. "(Oi)" advantages incorporate the "formal and informal institutions that govern the value-added processes within the firm, and between the firm and its stakeholders" (Dunning and Lundan 2008, 101).

Dunning points out that the host countries targeted for investment should have certain "Location-specific advantages" in order to encourage companies to conduct FDI. These advantages are related to the qualities such as host countries' market size, natural resource endowment, regulation framework, infrastructure bases and economy. Other factors worth mentioning are cultural, religious and political proximity or differences between the investing and the host country (Dunning and Lundan 2008, 102). "Internalization-specific advantages" or how a firm decides to conduct its FDI determines its strategy on controlling its investment (ibid, 103). Since the mode of the entry into the host country specifies firm's decision and strategies on exploiting its assets, a strong link between (I) and (O) advantages could be drawn (ibid, 140).

FDI as a mode of expansion to foreign markets occurs only if all OLI advantages follow. In absence of (L) advantages, the company's operations may be kept domestic. If ownership and location advantages exist but in absence of "Internalization-specific advantages", the company may only stick to exports and licensing of its products or services. (I) advantages encompass the benefits resulted from internally exploiting the (O) advantages by the company itself rather than sharing the rights of using them with another entity. (I) advantages have a great impact on company's choice of mode of entry into the new market. The choice depends on their strategies and long-term plans for exploiting their ownership advantages overseas (Dunning and Lundan 2008). According to Kalotay (2010, 24), companies may favor internalization of foreign operations for the uncertainties existed in relation to transaction costs and the possibility of losing control over technological advantages. However, the internalization process, itself imposes costs on the companies such as expenses related to acquiring assets overseas. For this reason, companies may prefer the minimum governance strategy. This could be possible through non-joint ventures or strategic alliances (ibid).

Dunning's OLI model divides companies' FDI incentives or the "motives driving firms to engage in foreign value adding activity" (Dunning and Lundan 2008, 25) into four categories: first; "resource-seeking"; second, "market-seeking"; third, "efficiency-seeking"; and lastly, "strategic asset-seeking investment" motives. In its basic manifestation "market-seeking investment" meets firm's incentive of finding a new market for its products or services. In other words, market-seeking investment" is related to the company, addressing the demand for its services or products. In this context, OFDI works as an alternative to export (Dunning and Lundan, 157; Liuhto 2015, 9). Company's presence in the targeted market assists with averting rivals, while maintaining the current customers (Dunning and Lundan, 159). "Market-seeking" goals require certain (O) advantages provided by the firm which differ based on variety of factors including: the industry that the firm belongs to, characteristic of the targeted market, nature of the business and managerial strength of the host country (ibid).

Resource-seekers are described as companies which look for acquiring certain types of resources overseas, at a lower cost or at a better quality. Companies may face shortage of such resources in their home country. The main determinant of the OFDI in this context is its contribution to the firm's competitive position in the regional or in the global market. Dunning identifies three types

of resources seekers as: first, companies that are interested in acquiring raw materials or primary goods. In this respect, OFDI is conducted with the motivation of cost reduction or securing access to supply resources. The second group consist of those enterprises that are interested in reducing their costs by employing cheaper workforce. The third type of resource seekers engage in OFDI with purpose of gaining technological capacity, expertise in managerial or organizational capability (Dunning and Lundan 2008, 68-69).

OFDI derived by “Efficiency-seeking” incentives concern with rationalizing the established market-based or resource-based investments for the firm to “gain from the common governance of geographically dispersed activities” (Dunning and Lundan 2008, 72). Such benefits are expected to be the product of “the economies of scale and scope and of risk diversification” (ibid). Dunning recognizes two types of “efficiency-seeking” investors. The first is related to a home country possessing factors such as finances, expertise or technology which could bring them to the host country that in return could provide the investor with the required labor or natural resources. The second group consist of parties, home and host countries, which are not that different in case of the factors needed for conducting the value-added activities. The main motivation driving the investment is taking advantage of the economy of scale and scope provided by the host country. Factors important for the home country would be characteristics of the host country’s policies and institutions, in addition to the potential degree of market competition and demand (ibid). This type of FDI is relied “on the benefits of the common ownership of diversified activities and capabilities, or of similar activities and capabilities in diverse economic and potential environments” (ibid, 73). Franco et al. (2008) finds this category similar to the resource-seeking” classification. For this reason, in an attempt to modify Dunning’s taxonomy of FDI, Franco et al. (2008, 2) keeps two classifications of “market-seeking” and “resource-seeking” motives, while creating a third category named as “non-marketable asset seeking”.

The last type of FDI motive, is “strategic asset-seeking investment”. This type of FDI aims at acquiring assets in overseas companies with purpose of increasing or maintaining the competitiveness in the international market. Such FDI goes beyond profiting and aims to strengthen against or unbalance the “ownership-specific advantages” of rival companies in the targeted markets (Dunning and Lundan 2008, 73).

There have been several attempts of modifying or simplifying Dunning's OLI paradigm (Franco et al. 2008, Narula 2010; Liuhto 2015). OLI paradigm is context (e.g. country, time, industry and sector) specific related framework (Dunning and Lundan 2008, 102; Liuhto 2015, 11). OLI paradigm is a recommended and employed framework for understanding the motives behind the Russian companies' OFDI (Kalotay 2008a, Kalotay 2010, Weiner 2018; Anwar and Mughal 2014; Liuhto 2015; Weiner 2018). A number of scholars found it necessary to adjust Dunning's OLI paradigm in order to place home country characteristics within the framework as a mean for analysis and explanation of Russian OFDI (Kalotay 2008a; Liuhto 2015; Weiner 2018). Kalotay's main criticism points at OLI paradigm's shortcoming in capturing the home-countries' factors. Kalotay argues that "Ownership-specific advantages" of a firm cannot be assumed to reflect that of the state (kalotay 2008a, 60). In addition, Kalotay (2008a, 59) elaborates on (O) advantages of Russian multinational companies, arguing that such organizations are more tend to expand based on their (Ot) advantages. In this case excess capital, organizational competence and managerial strength outweigh technological capabilities. Kalotay argues that (Ot) advantages are not necessarily "located strictly within the boundaries of the firm; they rather exist somewhere on the border line of the firm and its environment" (Kalotay 2010, 12), which is mainly the home country and economy. The "Oi" advantages introduced by Dunning is also very short on reflecting on the factors related to the home country, which mainly "incorporates the firm-specific norms and values guiding the decision-making, as well as an imprint of the institutional environment (L attributes) of the home country" (Cantwell et al. 2010, 572). Addressing the shortcoming of OLI paradigm, Kalotay expands the framework to OLIH in which "H" stands for "Home-country advantages" of the (H) factors. (H) advantages breakdown encompasses factors such as: "competitive environment, business environment, development strategy" and "[s]tate involvement" (Kalotay 2010, 1). The (H) factors are clearly distinguishable from "ownership-specific advantages" since the first cannot be ascribed to the companies' capabilities or intangible assets (ibid, 12). The four factors within "home-country advantages" are explained as follows: the "competitive environment" factor is referred to the firm's "home-country advantages" generated from its oligopolistic position in the home country. Russian giants, generally in the energy sector have a dominant position in the home economy which is also baked and supported by the national policies. The "business environment" factor within "home-country advantages" of Russia have been resulting the Russian companies to use OFDI for two different purposes, either for expansion or

for exodus (Kalotay 2010). Expansion is an advantage for the country in which the company is based in; however, exodus is the opposite (Weiner 2018, 21). According to Kalotay (2010,19), expansion of Russian companies overseas was on rise from the midst of 90s, however this trend changed to “exodus” with the beginning of the financial crisis of 2008 when the undesirable Russian economic environment motivated the Russian companies to move their capitals overseas. Development strategies prescribed by the home-country’s policies could create advantages for companies to invest abroad. “Home country state involvement advantages” of particularly “economies in transition are related to two main factors: government policies towards outward FDI: and State ownership in outward investing firms” (Kalotay 2010, 21).

Liuhto (2015, 11-15) bases his work on Dunning’s OLI framework and propounds ten main motives behind Russian companies’ OFDI as follows: first, “market-seeking investment” which encompasses “market entry and expansion” and “global competition” factors. The first concerns with the motive of location proximity to the customers overseas while bypassing intermediaries. The later comes from the necessities emerged from the globalized economic world pushing Russian companies to expand their international presence in the international market due to constraints of the national market. Second, Russian “resource-seeking investment” is largely motivated by transferring the capital overseas to be used as a “personal bank”. In other words, Russian companies use their presence in the host country to raise finances (e.g. in form of loans) needed for operations back in the home country. Liuhto (2015) identifies three factors driving Russian companies’ efficiency-seeking investment”: “raising profit margins” (by transforming from exporter of raw goods to companies involved in value-added activities), “tax planning and minimizing of customs fees” and “securing a company’s logistical chain” (establishing a Russian logistical unit abroad as an alternative to non-Russian entities providing the same service in order to secure the commodities export channels. Liuhto identifies “acquisition of advanced Western technology as the main incentive behind Russian companies’ “Strategic asset-seeking” OFDI. On the basis of Kalotay’s OLIH paradigm, Liuhto has its own take on of the “home-country factors” specifically for Russia as follows: “risk aversion” (avoiding political risk in Russia), “serving Russia’s foreign policy objectives” and securing a “Golden Visa” or long-term residency permit through investment in real state or in a business overseas. According to Liuhto (2015, 12), some of the ‘Russian companies’ OFDI incentives in under-developed countries cannot be explained by

business rationality objectives solely. The whole picture is completed when the investment is related to Moscow's foreign policy objectives.

The next section sheds more light on home-country advantages introduced by Kalotay (2008 and 2010) through the prism of neomercantilism. Next section assists with understanding Russia as a transition economy, In addition to the nature and characteristics of the state involvement in the market and the Russian major companies.

1.2. International political economy of outward foreign direct investment

World's new economic and political order of twentieth century sparked the emergence of a new scientific discipline, reflecting the requirements of a new era. An era structured around a string of worldwide developments such as deepening of the collapse of Bretton Woods monetary order, increase in the international economic interdependency, the rise of variety of international institutions and world's dependence on hydrocarbons, called for the need of IPE as an autonomous field of study in 1970s. At this age, economic issues became a matter of high politics which marked the end of the separation of economics and politics (Guzzini 1997,129).

IPE is commonly defined as a discipline studying the interaction of the state and the market at the international sphere (Gilpin 1987, 8). According to Cohn, "IPE is concerned with the interaction between the state, a sovereign unit, and the market, a coordinating mechanism where buyers and sellers exchange goods and services at prices determined by supply and demand" (Cohn et al. 2012, 3). States and non-state entities such as multinational companies and international organizations are all considered as critical world players interacting with the global market (Gilpin 2001, 17-18).

Main IPE approaches are known as realism, liberalism and Marxism. Realism encompasses a range of categories such as mercantilism, neomercantilism, economic nationalism and protectionism. Mercantilism strand of realism is the oldest approach, dating back to 15th century (Şimşek 2018, 29-30).

1.2.1. Placing neomercantilism within international political economy

Realism perspective established within IPE is constructed of various views and approaches, despite this variety the core arguments, assumptions remain the same. Cohn (2012, 56), identifies two

major trends in realist view which are applicable to IPE, the first strand is based on Machiavelli's (15th century) view and the second strand is related to Thucydides (471–400 B.C.) and the mercantilists' works. The first, identifies weak linkage between economic and politics. On the other hand, Thucydides and mercantilists identify stronger interaction between politics and economics. Long after Thucydides, in 16th century, mercantilists systematically theorized matters related to IPE through the prism of realism (ibid, 57). Mercantilism, assisted with nation-state building in Europe after the demise of feudalism, a doctrine dominated the political scene until British-led expansion of liberalism in late 19th century (Cohn 2012, 59; O'Brien and Williams 2016, 8). Early practices of mercantilism were based on the national policies of accumulation of wealth in form of silver and gold for strengthening the military forces with the end goal of dominating and influencing the rest of the world. Power-boosting was possible by obtaining valuable metals to developing manufacturing capabilities, decreasing import and increasing export possibilities of nationally manufactured goods. Influencing the rivals while protecting national interests took the form of constraining export of raw materials, technology and know-how knowledge. Mercantilism resulted in expansion of colonization in which colonies were seen as raw material suppliers. Colonies were also used as a market for colonizers' products (Cohn 2012, 19). In mercantilists' view, in a self-help international order, states engage in zero-sum game, which means they seek relative gains from global market and international relations (ibid, 59). Realist approach in IPE was developed into economic nationalism in 18th century as a response to aggressive liberalist practices of Britain (Guzzini 1997, 137). Cohn considers mercantilism as a force of pre-industrial era, mainly focusing on agriculture protectionism (Cohn 2012, 59). On the other hand, economic nationalists view, "industrialization" as a critical factor for state's independency, "Military power, security, and economic self-sufficiency" (ibid, 59). Under economic nationalism, states focused on building national unity, and their industrial capability for boosting their competitiveness in the global market. Free trade considered rational only after reaching to the level of industrial superiority (ibid, 60).

Economic nationalism is considered similar to realism, a well-known theory of international relations (Gilpin 2001, 14; O'Brien and Williams 2016, 8), in that it "recognizes the anarchic nature of international affairs, the primacy of the state and its interests in international affairs, and the importance of power in interstate relations" (Gilpin 2001, 14). More importantly, economic nationalism has "protection of the national unit" (O'Brien and Williams 2016, 8) at its core.

After the Cold War, neomercantilist strand of IPE realism, became a dominant approach which is mainly mentioned in the works of Robert Gilpin (1930- 2018). The Neomercantilism introduced by Gilpin has less emphasis on obtaining power through military and war waging practices (Guzzini 1997, 136). He puts initiative in understanding dynamics of power but not through international relations' theories but through neomercantilism which understands power in relation to economics. The other characteristics of neomercantilism introduced by Gilpin is that global interdependence has a stronger presence especially when compared with economic nationalism. Gilpin views the relationship between "state the embodiment of politics and the market as the embodiment of economics" (Gilpin 1987, 10) as "causal" and "cyclical" (ibid, 9). State and "market interact to influence the distribution of power and wealth in international relations" (ibid, 11). State is a means of obtaining wealth, as the political decisions driven by state's interest lead the "location of economic activities and the distribution of the costs and benefits of these activities" (ibid, 9). Competition in the international market and limitation in resources, makes states to influence and constrain the markets to secure their own interests. To do so, states seek more for augmentation of their power (ibid, 47).

In a self-help, anarchic international arena, mercantilism anticipates that states engage in a zero-sum game over limited resources which one state's success means the other one's loss. However, neomercantilists, consider the possibility of cooperation in which states may be satisfied with absolute gain rather than relative gain (ibid, 47). Even with presence of cooperation, states compete for maximizing their share of gain from markets. Exercising power becomes important when it comes to constructing and retaining market relations, since markets' dynamics impact states' political relations and vice versa (ibid).

Economic resources and wealth are the vital sources of national power working beyond shaping the market relations to maintaining or increasing security or for purpose of national aggrandizement and aggressive expansion in global economy. States adapt variety of national and international policies in response to other states' political and economic strategies. Balancing against rival states' military and warfare developments is another response for securing national power, market share and source of scarce resources (Gilpin 1987, 32). Gilpin explains the behavior of neomercantilist states in the international sphere by introducing two types of foreign policy and national economic policies adapted by the states, "benign mercantilism" and "malevolent mercantilism" (ibid, 32). The first, benign mercantilism, is defensive in nature while the former is

more offensive. Benign policies are implemented with the aim of protecting the national economy against the “external economic and political forces” (Gilpin 1987, 33). Malevolent mercantilist policies are shaped around territorial expansionist goals or for purpose of increasing economic and political leverage and influence which at an extreme level could turn into economic warfare (Gilpin 1987, 33; Balaam and Dillman 2014, 63). Gilpin distinguishes between benign and malevolent mercantilist policies; however, the issue with drawing the line between the two concept appears when one state’s benign mercantilist approach is interpreted as malevolent by another state (Balaam and Dillman 2014, 136). Neomercantilism, today employs variety of strategies including resource nationalism, technonationalism and monetary nationalism (ibid, 54). As mentioned before, unbalanced distribution of natural resources and increase in demand of scarce resources create insecurity for both supplier and consumer states. For addressing such economic insecurities, states adapt malevolent or benign mercantilist policies. Malevolent mercantilist policies could take forms of imposing sanctions, war with main goal of controlling natural resources supply, and Industrial and advanced technological espionage. In response to potential offensive policies of other states, governments seek for defensive means. For instance, China as one of the main importers of energy seeks for means of addressing its energy supply insecurity by direct investment in exploration projects globally. In addition, China concluded long-term oil agreements with African and Latin American countries. Both strategies, assists China to have access to energy resources without depending on one supplier or open market (Balaam and Dillman 2014, 72). States have been trying to influence and shape market dynamics to safeguard their own interests. This behavior is reflected in states’ strategies and policies regarding international trade and capital out or in-flows (Bhaduri 2002, 25). Balaam and Dillman, classify states’ neomercantilist policies into two main types: “industrial and infrastructural policies and strategic resource policies” (Balaam and Dillman 2014, 67-70). The first, industrial and infrastructural policies, explains governments’ initiatives for increasing domestic industries’ competitiveness in the global market. For this purpose, state develops policies which restricts or limits FDI inflows in strategic sectors while, domestic companies are supported by the state policies designed to fund research projects in addition to improving public education and infrastructure to increase their local businesses or the OFDI. The second strand, strategic resource policies is called as resource nationalism (Wilson 2011). Resource nationalism is a form of neomercantilism which advocates state intervention in

controlling strategic sectors or the ‘commanding heights’ for protecting the economic security of the state (Gilpin 1987, 24).

During mercantilist era, colonizers used to take control of territories rich with natural resources and militarily guarded their economic interests in these regions, while in today’s world states both natural resource suppliers and importers look for alternative means to protect their domestic economy and national security, including establishing cooperation and alliances with main natural resource suppliers, stockpiling natural resources, reserving energy resources on their own soil, increasing energy efficiency, advancing alternative energy resources or diversifying international suppliers. FDI and capital outflow is another instrument used. States engage in investing in exploiting projects overseas, increasing their control over other states’ strategic sectors through purchasing ownership, taking control over the value chain and shares of companies in targeted states. The main goal is dominating natural resources extracting companies and projects in addition to concluding concession rights and variety of joint ventures for exploration and production abroad (Balaam and Dillman 2014, 72-74). As stated by Gilpin, states influence, constrain and control market dynamics through rules and regulation. Resource-rich states’ economies are heavily relied on exploiting and exporting commodities. Their attempts of securing state’s economic and political benefits from international relations and global market is reflected in variety of their national and international policies (Wilson 2015b, 224; Balaam and Dillman 2014, 136). In such, states rich with strategic natural resources not only increase their power and security through commercial benefits out of commodity trades but also from other state’s reliance on their supply. In other words, natural resources supplier states’ economic and political security rely on their self-sufficiency and other states’ dependency (Balaam and Dillman 2014, 71-72). Neomercantilist states applying resource nationalism is expected to include variety of strategies and policies including nationalization of strategic industries, state ownership of vital sectors, enforcing industrial requirements and policies with purpose of controlling resource companies. Strategic industries may enjoy state’s support in form of subsidies. Taxation and fiscal policies could be designed for capturing economic rents from economic operations of strategic sectors in favor of the state (Wilson 2015a, p400).

Wilson (2015a), classifies the contemporary varieties of resource nationalism regimes as: rentier resource nationalism, development resource nationalism and market-based resource nationalism. Rentier resource nationalist states (e.g., Kazakhstan and Russia), take direct control of resource

rents distribution through direct ownership of energy and mining sector. These states' economy tends to be highly dependent on exploiting and exporting natural resources (Wilson 2015a, 405-408). States with development resource nationalist policies (e.g. Brazil, Chile, China, India and Indonesia), direct resource sectors into the development of national economy. State tax, trade and constraining investment policies are designed for incorporating resource productions into predefined national economic developments (Wilson 2015a, 408-409). Market-based resource nationalism is more practiced among developed economies (e.g. Australia, Canada and the US) which is distinguishable from the previous types since it lacks statist tradition as it does not advocate state-ownership and interventionist policies. Resource sector is market-based and open to foreign direct investment, state only use taxation policies for capturing economic rents.

1.2.2. Russia and Neomercantilism

The Collapse of the Soviet Union brought about radical political and economic reforms in the region, including Russia's transition to market economy. At political level, Russia experienced development from one-party regime to a more democratic and a multiple-party system. At economic level, Russia experienced a striking transition from state-controlled and centrally planned economy to a market-oriented model (Kim 2008, 184). In light of a series of privatization plans implemented in 1990s, Russian businesses exploited the opportunity of expanding beyond the Russian borders. The reforms provided the Russian companies with wealth and legal freedom for expanding abroad (Kuznetsov 2011, 36; Liuhto 2015, 5). Russian companies' FDI outflow has shown a significant increase from \$3 billion (UNCTAD 2003) in 1995 to \$344 billion in 2018 (UNCTAD 2019). Three decades after the collapse of the Soviet Union, in 2018, Russia has become the 12th largest OFDI state in the world (ibid, 4). The increase in the price of energy products and primary goods was a strong contributor to the growth of Russian FDI abroad (Kuznetsov 2011, 38). The economic and political transition brought about radical changes in the wealth and power composition of Russia internally and in face with the rest of the world. Russian national and international policies have been evolved from Yeltsin to Putin's presidency to address Moscow's regional and global goals.

Soviet Russian state possessed around 45,000 enterprises which under transition to market economy program, they undergone mass voucher k in 1990s (Sach 1992, 46).

As explained in the previous section, resource nationalist regimes take different forms, as in the case of Russia, it is best described as rentier resource nationalism. In 2000s, energy sector became a critical source of rent, revenue and power for Kremlin. A strong motive for the state to increase its control over the domestic oil and gas sector and ultimately taking control over wealth and rents distribution. The Russian energy companies were put at the frontline of building up Russia's economy as well as strengthening its geopolitical position (Ziegler and Menon 2014, 23). At this stage, Putin increased state's degree of control over the energy industry. Post Yeltsin's presidency is marked with state intervention in the economy and direct ownership of strategic sectors (Kim 2008, 200). After the implementation of privatization of 1990s, redirecting of the ownership to the state from the private sector with domestic and foreign investors was not an easy task. With the economic boost in Russia, the policy development started coming from the position of power. The war on oligarchs initiated by Putin decreased the bargaining power of the elites and oligarchs. As they found their survival in remaining loyal to the state and Putin's state-building agenda (kim 2008, 192; Ziegler and Menon 2014, 23; Wilson 2015a; 407).

During Yeltsin era, Russia's primary initiative became attracting foreign investors in the energy sector. The neomercantilist approach of the Putin's era led to protectionist measures and policies against foreign direct investment in the Russian energy sector. Either foreign direct investment was banned or very limited. Foreign direct investment may find its way to Russia if they could provide the lacking financing resources or when the domestic technological capabilities are unable to advance the energy projects (Ziegler and Menon 2014, 26). As it was the case in 2008, that Gazprom establishing venture partnership with Statoil (Norwegian energy company) and Total (French petroleum company) in the Liquefied Natural Gas (LNG) production project in the Shtokman gas field (Barents Sea). Gazprom partners were to assist the project with capital inflow as well as bringing in the know-how capabilities and the necessary technology which were underdeveloped in Russia. Gazprom possessed the major 51% stake, in addition to complete operation license ownership. Russian is more practicing a protectionist approach as it is limited and prohibited the foreign investment via acquiring licenses. The partnership obliged Statoil and Total to transfer their stakes to Gazprom according to the development of the project (Loe 2018, 756-760). The state control over energy projects went as far as forcing the foreign investors to pass on their shares and ownership of energy projects in Russia to the Russian state-owned companies. This was achieved through exploiting environmental and tax regulation in favor of Russian

companies by pushing the foreign investors back. A pattern of harassment of foreign investors became observable, as it was the case in 2006 when Royal Dutch Shell was forced to pass on its shares to Gazprom of Sakhalin Island field over environmental and safety issues. The similar series of accusations facilitated the acquisition of TNK-BP by Rosneft in 2013 (Ziegler and Menon 2010, 25). Putin also dealt with the Russian investors in the domestic projects within the energy sector in an assertive manner. Yukos affair (started in 2003) is one example of Putin's systematic attempt of taking over of energy companies. In yet another instance of "'selective application' of the law" (Yakovlev 2006, 1046) against Yukos oil giant and its CEO Mikhail Khodorkovsky which led to Rosneft gaining the ownership of the company.

1.3. Summary

The main objective of this thesis is explaining the economic and political incentives behind the Russian state-owned investment in the energy sector of Kurdistan of Iraq. Two theoretical paradigms introduced in the previous sections are complementary, which assist with answering the research question in a structural way. As OLI paradigm suggests, at firm level the economic objectives can be explained and classified by/as "resource-seeking"; second, "market-seeking"; third, "efficiency-seeking"; and lastly, "strategic asset-seeking investment" motives. However, the "home-state factor" and neomercantilism propound more forces behind companies' FDI, particularly if these enterprises belong to the strategic industries within the extractive sector. "Home-state factors" explain the decisions made by the company based on the economy and business environment of the home country, in addition to the state degree of control over the commanding heights and OFDI policies. The neomercantilism approach assists with the further understanding of the political objectives of the state behind the state-owned companies' OFDI. Based on neomercantilist view states employ economic means for maintaining or increasing power. Scarce resources in hands of states work as an instrument for changing the dynamics of power and the distribution of wealth in the global arena. States with such worldview take control of industries with high wealth generation potential which could ultimately increase their power and strengthen their political position in their international relations. States and the state-owned companies work together to penetrate in the global market, but it is the state which should augment enough power and wealth in order to back and direct the companies in order to achieve their economic objectives in the international market. The "location-specific advantages" as defined by

Dunning reflects the economic advantages offered by the host country. Neomercantilism suggests that states show interests in locations where exploiting assets could generate both economic and political profits. Exploiting ownership advantages in addition to Internalization advantages are critical determinants of FDI motives in OLI model, but also defining elements in neomercantilism. (O) advantages are required competent for companies' competitiveness in the international market which ultimately defines the company's success in generating wealth for the state. Internalization is the critical mean for securing the ownership advantages and ultimately serves the economic security. A neomercantilist state may invest abroad through its state-owned companies not only for maximizing profits and developing its economy, but also for a strong foothold in monopolistic or oligopolistic industries such as the extractive industry. Internalization of operations and markets assist such states to maintain their share in the international market while minimizing transaction costs and protecting their competitive assets.

As illustrated in figure 1, the theoretical section provides few expectations generated from the relation between the independent variables and the dependent variable. The expectations are: first, Russian state-owned companies' FDI in the energy sector of Kurdistan of Iraq are derived by both economic and political motives; second, the economic and political motives are suggested by the state in accordance with the policies designed for protection of the national security; and third, the political ambitions are required means for economic building and wealth generation purposes.

Regarding the first and second expectations, neomercantilism suggest that states engage in investing in exploiting projects overseas in order to increase their control over strategic sectors of other states, in addition to increase their access to diversified sources of energy supply.

These expectations could be translated into the following hypotheses:

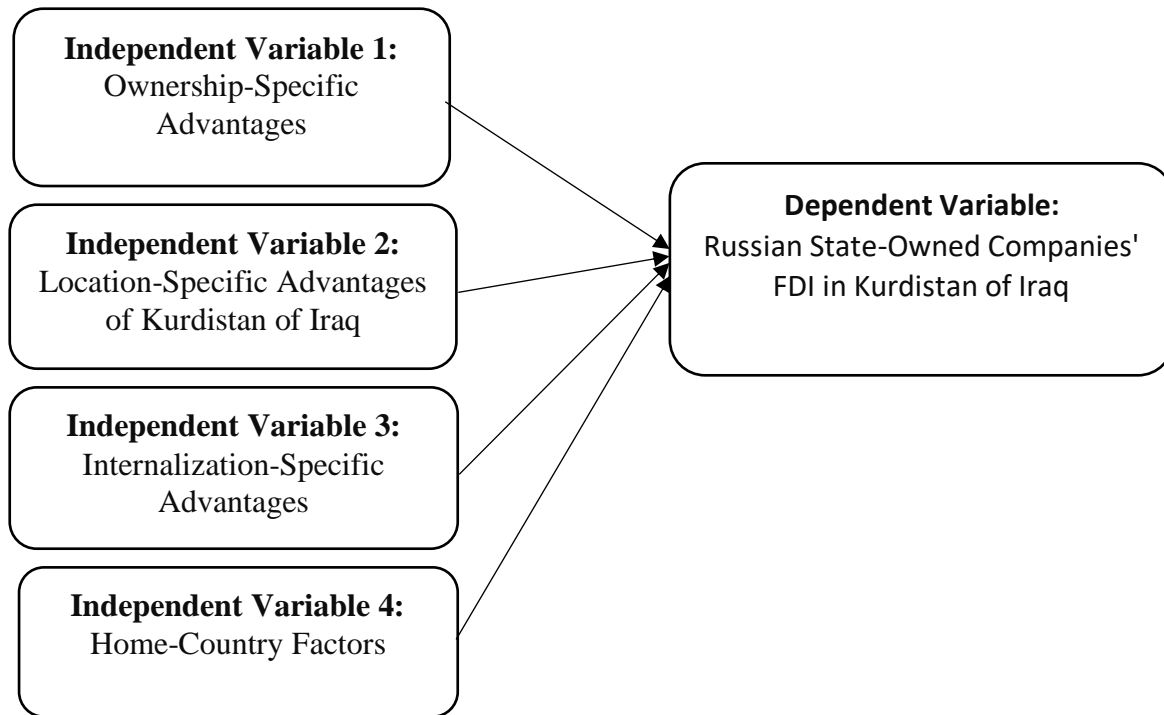
Hypothesis 1: *Russian state-owned companies' FDI motive in KRI is related to natural resource seeking.*

Hypothesis 2: *Russian state-owned companies' OFDI in the energy sector of KRI are in accordance with the national and international policies of their home-country.*

Independent variables 1 to 3 explain the causal relationship between variables for the first hypotheses. The last independent variable or home-country factors are the main contributor for

explaining the second hypotheses. The following chapter presents the research method and empirical analysis in relation to the hypotheses formulated above.

Figure 1- Relationship between the independent variables and dependent variable



Source: Self-designed- Dunning and Lundan (2008) and Kalman Kalotay (2010)

2. Research methodology

This chapter explains and argues for the object of the study and the research design employed for the purpose of this thesis. The chapter starts with describing the object of the study, research design, research strategy and it continues with explaining the research method and lastly the data collection method employed in this thesis.

For understating the economic and political incentives behind Russian state-owned companies' expansion into KRI's energy sector this research focuses on the companies' "ownership-specific

advantages” and “internalization-specific advantages”, KRI’s “location-specific advantages” and lastly, the “home-country factors”. The first three variables are understood as firm-level explanations for Russian companies’ OFDI or expansions into KRI. The last variable, “home-country-factor” is taken as the describer of the state as an additional dimension of decision-making force behind the Russian companies’ state-owned FDI outflow. The fundamental question of this thesis is: “What are the main economic and political incentives behind the Russian state-owned energy companies’ OFDI in KRI?”

The study is limited to the FDI outflow conducted by Russian companies in the energy sector of KRI. The research showed that only two major Russian companies have been operating in KRI, Gazprom and Rosneft, since 2012 and 2017, respectively. Studying the determinants behind the investment conducted by the two Russian giant hydrocarbon companies in the energy sector of KRI contributes to the understanding of the scope of Russian state-owned energy companies’ operations, investment strategies, OFDI pattern and determinants in a risky market and less-developed country. Russian energy companies have been expanding in multiple places in the global market, however their presence in KRI is a new phenomenon.

2.1. Research design and the research strategy

This thesis employs explanatory single-case study which allows to study the dependent variable “Russian state-owned companies’ OFDI in KRI” through the OLIH paradigm and the neomercantilism approach. Yin (2003, 1) acknowledges a case study as a relevant research strategy “when “how” or “why” questions are being posed, when the investigator has little control over events, and when the focus is on a contemporary phenomenon within some real-life context” (ibid). Case study as a research strategy is “based on the in-depth empirical investigation of one, or a small number, of phenomena in order to explore the configuration of each case, and to elucidate features of a larger class of (similar) phenomena, by developing and evaluating theoretical explanations” (Vennesson 2008, 226). According to Yin: “[d]ata analysis consists of examining, categorizing, tabulating, testing or otherwise recombining both quantitative and qualitative evidence to address the initial propositions of a study” (Yin, 2003, 109). This thesis employed, explanation building, a suggested data analysis technique by Yin (ibid). This technique assists with analysis of data with purpose of testing the hypotheses. As the case study is explanatory one, a

series of variables are provided which assist with creating causal links and evidence gathering and the final decision over supporting or rejecting the hypotheses (Yin, 2003, 120).

This thesis investigates projects conducted by Gazprom and Rosneft in KRI. Gazprom has signed two Production Sharing Contracts (PSCs) with KRG. In 2012, Gazprom entered in Garmian oil field with 40% stack, and subsequently, started operations in Shakal oil field in 2017 with share of 80%. Rosneft has engaged in the energy sector of KRI later than Gazprom, however it has had more presence in hydrocarbon related projects in comparison with its other Russian rival. In 2017, Rosneft signed an advance payment agreement with KRG with worth of \$2.1 billion for the period of 2017 to 2019. In the same year, Rosneft entered a joint venture with KRG in infrastructure projects of KRI with 80% stack. Monetization and operation of an oil pipeline has been part of this project. In addition, Rosneft's subsidiaries are active in KRI through five PSCs in five different oil fields in KRI, with possessing 80% of shares. Rosneft has also showed interest in construction and operation of an export gas pipeline in KRI, for which a series of agreements have been signed between the company and KRG.

2.1. Research method, data collection-analysis, variables and measurements

Qualitative research method approach is selected for the purpose of this thesis. Russian companies' OFDI conducted in KRI, as well as operations completed in the region are small, for this reason the available data is not sufficient and reliable for quantitative research method and analysis. It is worth mentioning that Russian companies' investment in KRI is a new phenomenon and no study has completed in order to investigate the political and economic drivers of these investments.

A set of hypotheses were established on the basis of OLIH paradigm and Neomercantilism approach, which were the starting point of the data gathering and analysis. The first part would be exploring the independent variables extracted from OLI paradigm. OLI paradigm provides the independent variables and related indicators which assist with explaining the OFDI of Gazprom and Rosneft at firm level. The next stage would be gathering data and analyzing home country factors. The Home country factors provide a complete picture which include the role of state in directing Russian companies' OFDI.

OLI paradigm provides indicators related to the independent variables measuring the FDI motives which are operationalized as to take two forms: observed or not observed. With the indicators

observed within each classification of independent variables then it could be concluded that natural resource seeking motives are valid in relation to Gazprom and Rosneft's FDI, as the hypotheses 1 states: OLIH advantages meet with Russian state-owned companies' FDI motive in KRI. A motive based classification of natural resource seeking FDI and the related indicators are listed in the following table.

Table 1 – Independent variables and indicators related to the resource-seeking motive

| Specification | Independent variables | Indicators |
|--------------------------------|------------------------------------|---|
| Resource-Seeking Motive | Ownership-Specific Advantage | Access to markets |
| | Ownership-Specific Advantage | Revenue and capital |
| | Ownership-Specific Advantage | Technology |
| | Location-Specific Advantage | Availability of oil and gas resources |
| | Location-Specific Advantage | Energy transit infrastructure |
| | Location-Specific Advantage | Favorable petroleum fiscal regime |
| | Internalization-Specific Advantage | Access to oil supplies and favorable oil prices |

Source: self-designed - Dunning and Lundan (2008)

In the following a description of independent variables explaining the dependent variable “Russian state-owned companies' OFDI in KRI”, indicators and data sources are presented.

Independent variable 1: “Ownership-Specific Advantages”

This set of variables describe companies' competitive advantages when expanding overseas.

Access to markets:

This indicator reflects Gazprom and Rosneft's integration into the national and international markets in addition to integration down the value chain. The data related to this indicator was extracted from Gazprom and Rosneft's annual reports and their websites.

Revenue and Capital:

This indicator is considered with revenue and capital capacity of Gazprom and Rosneft. Revenue growth of both companies is taken as an indicator of efficiency of economies of scale and their vertically integration business. Companies' financial capabilities is a critical competitive advantage when it comes to investing in large capital requiring oil and gas projects. The data for this section was sources from financial statements of Gazprom and Rosneft.

Technology:

This indicator was evaluated irrelevant for the purpose of this study. Here, technology is referred to as exploration and production related ownership-specific advantages. Technologies in extractive sector do not give companies competitive edge, if the projects are not of complexity nature (UNCTAD 2007, xxiii). KRI's oil fields are all located onshore, and the explorations, drillings and liftings of crude are far from requiring sophisticated technologies (Mackertich and Samarrai, 2015).

Independent variable 2: “Location-specific advantages”

This independent variable encompasses a series of advantages related to the host country which may attract the investments of the international companies.

Availability of oil and gas resources:

This indicator illustrates and measures the oil and gas reserves of KRI as a region within Iraq. The data related to the oil and gas reserves in addition to the amount of production and export from Iraq is extracted from Kurdish Ministry of Natural Resources and U.S. Energy Information Administration (EIA) databases.

Energy transit infrastructure:

This indicator is related to the quality and development of midstream sector of KRI. The data related to KRI and Iraq's oil and gas transportation capacity, pipelines and main routes were sourced from EIA databases.

Favorable petroleum fiscal regime:

Dunning's model suggests tax arrangements as one of the indicators of the host-country's location-specific advantage. I expanded the indicator to petroleum fiscal regime since it is more sector-specific and it encompasses variety of factors including tax fees and revenue arrangements which play an important role when an international company evaluate a host country's attractiveness. Petroleum fiscal arrangements is designed with the main purpose of regulating profit allocation among the host country and the international companies. Such arrangements are great indicators of attractiveness, stability, fairness and predictability of tax charges and revenue allocations generated from the oil and gas investments and projects in a host country (Cameron and Stanley 2017, 177). Petroleum fiscal system of KRI was considered as the combination of Kurdistan

Region Investment Law (passed in 2006), KRG's Oil and Gas Law (enacted in 2007) and the Model PSC suggested by KRI's Ministry of Natural Resources. Under a PSC, the international company takes on exploration and production activities in an oil or gas field. A PSC generally requires the international company to make payments to the host country in form of tax, bonus, royalties or signature payments (EY 2019, V). These factors could impact the desirability of these PSCs. The data related to tax arrangements in KRI and other countries were sourced from Ernest and Young Global Tax Guide published in 2019. PSC Model of KRI was another source for more arrangements such as royalties.

Independent variable 3: Internalization-Specific Advantages

This independent variable has a great weight on a company's decision on its mode of entry into a host country. The following indicators are related to the motives of why Rosneft or Gazprom may prefer to decide to exploit their ownership advantages in KRI's oil and gas sector:

Access to oil supplies and access to favorable oil prices:

This indicator concerns with having control over oil outputs at a stable, moderate or cheap price. These indicators describe the main objectives of any oil and gas giant in the energy market, which is being able to meet the supply contracts to customers may locate at different locations in the world, while supplying subsidiaries and other branches along the value chain (e.g. refineries). Access to cheap energy supply could be both at trading and production points. The discounted price of crude oil exported from KRI was sourced from Iraq Energy Institute reports. The details of exploration and production costs were not provided on Gazprom and Rosneft's annual reports or on their websites, for this reason they were sourced from an academic work and annual reports of other transparent companies functioning in KRI. Cheaper crude oil prices were taken as an internalization incentive for Gazprom and Rosneft to have a foothold in KRI.

Home-country factors

The previous indicators were more concerned with economic aspects of expansion of energy companies beyond their domestic markets. The "home-country factor" and neomercantilism propound more forces behind companies' FDI, particularly if these enterprises belong to the strategic industries within extractive sector. Combining "home-country factor" introduced by Kalotay (2010) and neomercantilism approach generate indicators that are presented under the

same name as an independent variable: first, expanding overseas in line with Russia's economic goals and second, expanding overseas in line with Russia's political goals. The first indicator may overlap with, company's commercial and economic objectives, however the difference would be that the decision-making force is beyond the firm's management level.

It is gathered from Kalotay (2010) and neomercantilism that in Russia state takes control of the commanding height for variety of reasons. As suggested by neomercantilism approach, Russian state takes stakes in strategic companies and directed their capital outflow to specific regions could signal as influencing the international market for particular economic or political goals. Two sets of data were gathered in respect to these indicators. First, data about state's view of Russia's economic position in the world, and Russian companies' role in achieving state's goals was gathered from the energy strategy of Russia (2010 to 2030), foreign policy concepts of Russia and Russia's national security strategy up to 2020. The first Foreign Policy Concept (hereinafter the Concept) of the Russian Federation was approved in 2000 since then the document was updated several times in 2008, 2013, and the latest one in 2016. The Concepts mentioned were all approved by Vladimir Putin as the president of the Russian Federation, except for the Concept of 2008 which was approved by the Dmitry Medvedev. For the purpose of this thesis, the documents approved from 2008 were considered. The underlying reason is that Gazprom and Rosneft's investments in KRI started in 2012 and 2017. The second group of data was gathered from different sources in relation to Rosneft and Gazprom's operation's in KRI. The comparison between two sets of data provides an understanding about the role of home-country factors on Gazprom and Rosneft's operations in KRI.

3. Research findings and analysis

The first and second sections of this chapter provide a brief overview of Gazprom and Rosneft's shareholder structure. Then it moves to the third section which explains the cooperation of Rosneft and Gazprom with KRG and their investments in KRI. The research findings then explain the economic and political motives behind the Russian state-owned companies in KRI. As explained in the Methodology chapter, Gazprom and Rosneft's economic motives driving their OFDI in KRI are presented based on Dunning's OLI paradigm. On this basis, the data collected will be presented in the following chapter under the categories of "resource-seeking", "market-seeking", "efficiency-seeking". It is expected that FDI conducted by a company reflects its strategic response

to exploiting its own “ownership-specific advantages”, the host country’s “Location-specific advantages” in addition to the “Internalization-specific advantages”. Home-country factors are used for explaining the role of Russian state economic and political aspirations in driving Gazprom and Rosneft’s FDI.

3.1. A descriptive overview of Gazprom Neft Middle East B.V.’s investment in KRI

Public Joint Stock Company Gazprom (PJSC Gazprom) is the frontrunner in Russia’s energy sector, as well as a key force in the global energy market. PJSC Gazprom is controlled by the Russian state which owns more than 50% of the company’s shares. In 2006, PJSC Gazprom Company bought 75.68% stock of the oil company, Sibneft. After the acquisition, Sibneft was rebranded to Gazprom Neft. Today, PJSC Gazprom holds 95.68% of the Gazprom Neft’s shares. Gazprom Neft is vertically integrated oil company engaged in variety of activities such as exploration, production, refining and sales of hydrocarbon products. The company has expanded its operations geographically to Serbia, Italy, Iraq and Venezuela. Gazprom Neft currently runs its operations in KRI through its subsidiary, Gazprom Neft Middle East B.V. (hereinafter Gazprom).

In Iraq, Gazprom Neft is engaged in a Service Contract with 30% stake for developing the Badra oilfield since 2010. The investment was estimated to be around \$2 billion (Gazprom 2020). The Badra oilfield was commissioned in 2017, since then the production has reached to 170,000 bpd but ultimately dropped to 75,000 bpd in 2019. The oilfield was estimated to contain around 3 billion barrels of light crude oil, however one of the reservoirs founded to be unproductive in the process. The Associated Petroleum Gas (APG) produced and processed in the Badra oilfield is about 1.6 billion cubic meters per year. Gazprom Neft was engaged in building facilities for processing gas. The APG plant supplies Dry marketable natural gas to the AL Zubaida electricity station through a pipeline. The oilfield has an important role in producing electricity for several provinces in Iraq. The facility also produces Natural Gas Liquids (NGLS) which is sent to the Iraqi Gas Filling Company for domestic use (Gazprom 2017). Gazprom Neft’s investment in the project was compensated by 500,000 barrels of oil supplied from Kirkuk oil field in 2015. The shipment was delivered to Turkish port of Ceyhan by the Iraqi parties (Gazprom 2020).

In 2012, Gazprom signed a Production Sharing Contract (PSC) with KRG for operations in Garmian and Shakal oil blocks. It is estimated that the blocks possess more than 500 million tons of hydrocarbon reserves. In the Garmian oil Block, Gazprom shares the PSC with the Canadian

natural resources company, WesternZagros Resources Ltd., in the agreement each possess 40% working interests, while KRG holds 20% interests. Saqala oil field is located in Garmian block, housing three wells Sarqala-1, Sarqala-2 and Sarqala-3, is estimated to contain 13 million barrels of oil. In 2016, Gazprom overtook the operatorship of the Garmian Block. Commercial production of sweet dry light crude oil from Sarqala oil field started in 2015 and it has reached to 23 million barrels (35,000 bpd) by the end of 2019 (Gazprom 2019b).

In Shakal block, Gazprom possess 80% interest, with KRG holding 20% stake (Gazprom 2013). The block has not yet reached to the production stage and has been undergoing well testing processes. In 2019, Gazprom announced unsatisfactory results from the project and the possibility of ending their involvement (Gazprom 2019a). The company had had operations in Halabja block as well, however, the plans for this project was suspended. Gazprom holds 80% stake in Halabja block with KRG possessing 20% of the stake (Gazprom 2013). In 2017, Sergei Petrov the general director of Gazprom Neft Middle East stated that the Halabja block was relinquished due to unsatisfactory results of the standard geologic studies in 2016. In an interview, Denis Sugaipov, the head of upstream projects of Gazprom Neft stated: “It’s possible those projects we’re involved in in Kurdistan...Sarqala, Shakal and Halabja...were somewhat overvalued initially. What is well known is that we’ve already taken the decision to quit Halabja” (Gazprom 2019a).

3.2. A descriptive overview of Rosneft’s investment in KRI

The Open Joint Stock Oil Company Rosneft (hereinafter Rosneft) is the leading state-owned petroleum entity in the Russian energy sector, which is ranked as the largest public oil and gas company in the world. The Russian state controls Rosneft through ownership of over 50% share of the company, acquired through Rosneftegaz JSC, an entirely state-owned organization, in addition to the State Property Management, a federal agency. Among the non-Russian major shareholders of Rosneft, stand BP and QH Oil Investments LLC, with 19.75% and 18.93% ownership of shares, respectively.

Rosneft’s involvement in Iraq’s energy sector goes back to 2016 when the company acquired PJSOC Bashneft. Rosneft possess 57.67% interest in Bashneft, a vertically integrated Russian company. With the acquisition, Rosneft inherited cooperation in variety of projects in Myanmar, Iraq, Canada and Ukraine. Bashneft International B.V., now a Rosneft subsidiary is the project operator in Iraq’s block 12, in which it possesses 100% interest of hydrocarbon exploration and

production. The exploration drillings in Block 12 started in 2017 and the project continued with discovery of commercial oil reserves in 2018. The oil field is not yet at production stage (Rosneft 2018a, 95).

Rosneft-KRI cooperation started in February 2017, at the International Petroleum week in London. Both parties signed an agreement on upstream and downstream operations. As part of the agreement, Rosneft made an advance payment to KRG for the supply of the KRI's crude oil to Rosneft Trading SA over a two-year term of 2017-2019. As declared in the financial statement of Rosneft (2017a, 290), the amount transferred for the pre-payment was about \$2.1 billion. Following the advance payment agreement, in June 2017, during the twenty first St. Petersburg International Economic Forum, the scope of cooperation in hydrocarbon exploration and production between KRG and Rosneft expanded further. Ahead of the economic forum, a series of agreements were concluded by heads of Russia and KRI, Putin and Nechirvan Barzani. In addition to Igor Sechin and Ashti Hawrami, the chief executive officer of Rosneft and the minister of natural resources of the KRI, the other signatures of the agreements (Rosneft, 2017a).

As part of the agreements, Rosneft and KRI entered a joint venture in relation to infrastructure system of KRI. This includes access transportation system, in addition to monetization and operation project of the export oil pipeline of KRI. The regional transportation system provides Rosneft with 700,000 to 1 million barrel capacity per day (ibid). Rosneft's financial statement (2018a, 307) shows a prepayment amount of \$1.8 billion to KRI in relation to the commitments to the infrastructure project and operation of the export oil pipeline referred to as KROP by Rosneft but generally as KRG's independent oil pipeline. This \$1.8 billion is from the \$2.1 billion pre-payment agreement which later was converted to Rosneft's stake in the pipeline ownership (Farchy et al. 2020). Rosneft announced the completion of the due diligence phase of KROP infrastructure project in 2017 (Rosneft, 2017d). The joint venture is managed through Kurdistan Pipeline Company Pte. Ltd., Singapore-based, in which Rosneft possess 60 percent of shares, while the remainder is owned by a Kurdish company named KAR Group (Rosneft 2019a, 62). Since 2017, the KROP's capacity has been increased from 700 thousand to 1 million bpd. In January 2019, Rosneft announced the enforcement of a concession agreement in relation to the operation of the export through KROP. The crude oil pipeline is estimated to export 950,000 bpd. The concession

term is for twenty years with option of possibility of extending up to five extra years (Rosneft 2019b).

In October 2017, Rosneft signed five PSCs with KRG for five oil fields, with estimated 670 million barrels of recoverable crude oil reserves (Rosneft 2017a, 160). The PSCs granted by KRG are led by five subsidiaries of Rosneft, which are all registered in Singapore under names of “RN-Batil Pte. Ltd.”, “RN-Zawita Pte. Ltd.”, “RN-Harir-Bejil Pte. Ltd.”, “RN-Darato Pte. Ltd.”, and RN-Qasrok Pte. Ltd. (Rosneft 2018a, 13). The subsidiaries are named after the oil fields they operate in. PSCs has entitled Rosneft of exploration, development and extraction rights of five oil fields with 80 percent stake for Rosneft’s subsidiaries, while KRG holds 20 percent share. Rosneft’s investment for the early stages of exploration of the oil fields such as collecting geological information and farm-in has reached to \$400 million. According to the agreements, oil production of the blocks will be used for compensation of half of Rosneft’s investment. (Rosneft 2017c).

In October 2017, at the Tenth Eurasian Economic Forum which was held in Verona, Rosneft signed a “Gas Cooperation Agreement” with KRG. The scope of arrangements encompasses construction of a natural gas pipeline in addition to engaging in an integrated gas project in KRI. Rosneft expansion in Kurdistan’s natural gas sector is a response to the agreements concluded between the company and KRG in June 2017, at the twenty first St. Petersburg International Economic Forum (MNR 2017). The gas pipeline with planned capacity of 30 billion cubic meters, aims to supply the domestic needs of KRI such as power plants and industries, in addition to increase the possibility of export to the Turkish and European market (MNR 2017; Rosneft, 2017d). In May 2018, both parties at the twenty second St. Petersburg International Economic Forum, expanded their cooperation and agreements in the energy sector of KRI. Following the event, Rosneft announced its commitment on conducting a pre-Front-End Engineering and Design (pre-FEED) of Iraqi Kurdistan's gas pipeline construction and operation” (Rosneft 2018b).

3.3. Ownership-specific advantages

A combination of tangible and intangible assets of a company create a competitive edge at the time of expanding into the international market. What a company possess or could exploit determine “why” it expands beyond the domestic market. The following indicators are suggested by OLI model in relation to ownership-specific advantage independent variable.

3.3.1. Access to markets

Gazprom and Rosneft are among the major Russian vertically integrated oil companies with expertise in array of upstream and downstream activities. Both companies are active in exploration, production, refinery, transportation, marketing and trading of oil and gas products.

Gazprom's domestic and overseas overall hydrocarbon reserves has reached to 2.86 billion tons of crude oil in 2019. Gazprom is responsible for 12% of global gas production and 69% of Russian gas production. In addition, Gazprom possess 16% and 71% the global and Russian gas reserves respectively. In 2018, Gazprom has produced 40.9 million tons of oil, 15.9 million tons of gas condensate, and 497.6 bcm of natural gas in its independent productions. The joint production volume of the oil production projects in which Gazprom has 7.4% share was 48.3 million tons of crude oil, in 2018. Gazprom's geographically expansion include European countries (Latvia, Estonia, Italy Serbia, and Romania), Latin America (Venezuela), the Middle East (Iraq, including KRI), and Commonwealth of Independent States (Belarus, Kazakhstan, Kyrgyzstan and Tajikistan). Within Russian borders, Gazprom is engaged in multiple hydrocarbon production projects including operations in 138 oil gas fields which encompass 7,418 gas and 8,489 oil wells. Gazprom's refineries' output has reached to 41.5 million tons in 2018, which was supplied to 50 countries. Gazprom's main oil and gas production projects are in Russia, with other key production sites in Serbia, Iraq, Venezuela.

Rosneft's proven hydrocarbon reserves were estimated as 5.6 billion tons in 2018. Rosneft is responsible for 40% of Russian domestic oil production and 6% of global oil production. In 2018, Rosneft's hydrocarbon production reached to 285 million tons. Gas production in 2018 amounted to 67.26 bcm. Rosneft's gas business is dependent on its subsidiaries and joint ventures' operations in Russia, Siberia, Vietnam, Venezuela, Canada and Egypt. Rosneft has strengthened and planning for further development of its refinery and trading divisions with main goal of diversifying its oil monetization channels. Rosneft stands at the top of refining business in Russian and is responsible for 35% of total refining outputs within the country. Rosneft possess 13 refineries in Russia and has invested in refinery assets overseas, mainly in India (capacity in 2018: 19 million tons), Germany (capacity in 2018: 11.5 million tons) and Belarus (capacity in 2018: 2.1 million tons). In 2018, the refining output of Rosneft reached to 115 million metric tons. Rosneft's trading division has established different entities for supplying the Asian and European markets. Rosneft Trading

S.A., based in Switzerland, has been Rosneft's main subsidiary supplying crude oil to Rosneft's refineries in Germany since 2011.

Vertically integrated oil companies with international presence, have better access to capital, organizational competence, project management skills and common governance advantages. In addition, it is more possible for such companies to find oil and gas buyers and importers through their trading arms or supply the hydrocarbon products for the refinery business elsewhere.

3.3.2. Revenue and capital

In the previous section, Gazprom and Rosneft's integration into national and international market was described, in addition to their expansion in variety of value adding operations within the industry. In the following section Gazprom and Rosneft's revenue and finance generating capacity will be explained. Revenue growth of both companies is taken as an indicator of efficiency of economies of scale and their vertically integration business.

Table 2 - A brief overview of the annual financial results of Gazprom (in billions of Russian Rubles)

| Gazprom | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 |
|----------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|
| Revenue | 3,597 | 4,637 | 4,767 | 5,249 | 5,589 | 6,073 | 6,111 | 6,546 | 8,224 |
| Profit | 997 | 1,342 | 1,252 | 1,165 | 157 | 805 | 997 | 766 | 1,529 |
| Investments* | 668 | 608 | 540 | 567 | 677 | 808 | 730 | 867 | 1,097 |
| OFDI* | 290 | 226 | 213 | 228 | 176 | 210 | 218 | 244 | 324 |

*Investments in associates and joint ventures

Source: Financial statements of Gazprom

Based on details provided in tables 2 and 3, Gazprom and Rosneft both continued to generate year-on-year revenue growth. Combining it with profit growth history it could be concluded that both companies were successful with efficiently exploiting their assets in their different geographical operations.

Table 3 - a brief overview of the annual financial results of Rosneft (in billions of Russian Rubles)

| Rosneft | 2010 | 2012 | 2016 | 2017 | 2018 | 2019 |
|----------------|-------------|-------------|-------------|-------------|-------------|-------------|
| Revenue | 1,915 | 3,078 | 4,988 | 6,011 | 8,238 | 8,676 |
| Net income | 319 | 342 | 192 | 297 | 649 | 805 |
| Investments* | 63 | 269 | 393 | 635 | 735 | 803 |
| OFDI* | 0 | 77 | 164 | 372 | 474 | 529 |

*Associates and joint ventures

Source: Financial statements of Rosneft

In comparison with Rosneft, Gazprom has been more engaged in investing domestically rather than internationally. In the past decade, Gazprom's overall investment doubled in amount, however, the share of OFDI remained almost the same (table 5).

Investment in the oil and gas projects requires significant capital and access to finances. Less developed countries may face difficulties in raising funds domestically or obtaining low interest finances in the international financial market due to the high risk associated with their credibility. In many cases, governments find international companies' investments as a more convenient source for pursuing country's long-term plans such as upstream and downstream projects. Kalotay and Sulstarova (2010,137) consider excess capital as a type of (Ot) advantage exploited by companies in their expansions overseas. However, corporations such as Rosneft and Gazprom have also the ability of raising excess funds in form of long-term liabilities (UNCTAD 2007, xxiii). Companies such as Gazprom and Rosneft have been successful in raising the finances backed by state (federal loan bonds), Russian and foreign bank loans (see table 4 and 5).

Table 4 – Gazprom's long-term borrowings - bond and bank loans (in millions of Russian Rubles)

| Gazprom | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 |
|----------------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|
| Long-term Borrowings | 1.178 | 944.2 | 1368.2 | 1698.2 | 1443.87 | 1,500 | 2,099.19 |

Source: Financial statements of Gazprom

Table 5 – Rosneft's long-term borrowings - bond and bank loans (in billions of Russian Rubles)

| Rosneft | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 |
|----------------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|
| Long-term Borrowings | 211 | 488 | 1,216 | 1,040 | 1,671 | 1,783 | 3,413 |

Source: Financial statements of Rosneft

The next section is dedicated to the "location-specific advantages", the second classification of economic factors of OLI paradigm, contributing to FDI of companies. A series of location advantages offered by KRG and available in KRI with potential to attract FDI of international companies in the oil and gas industry such as Gazprom and Rosneft.

3.4. Location-specific advantages of Kurdistan of Iraq

As explained in the theoretical chapter, a host country should exhibit a series of advantages in order to attract FDI. “Location-specific advantages” entail a set of factors which explain the motives behind a company’s OFDI. These factors are related to the host country’s economic characteristics, extractable natural resources deposits, business and regulation facilitations, religious or political proximity. The criteria are mainly related to geological capacities, profitability of projects, government policies or regulatory systems. Considering the main focus of the thesis, which is on the energy sector of KRI, the key indicators for Gazprom and Rosneft’s OFDI are the geological capacities and the petroleum fiscal arrangements between international companies in KRI and KRG.

3.4.1 Availability of oil and gas resources in KRI

One of the location-specific indicators motivating international companies to invest in a specific country is its promising oil and gas capacity. Neomercantilism suggests that expansion overseas to hydrocarbon-rich countries could be motivated by taking control of the supply chain or the strategic sectors in other markets. In this respect, Iraq as a country endowed with significant hydrocarbon deposits is an attractive destination for oil and gas corporations’ FDI. Kurdistan’s oil and gas reserves are part of Iraq’s energy endowment; however, it requires a separate study since these reserves are regulated and controlled in a different business and regulatory environment in comparison with the oil and gas deposits under control of Baghdad.

Iraq possesses the fifth largest proved oil reserves in the world which is estimated to be around 149 billion barrels. This amount represents 18% of the total crude oil reserves of the Middle East. Putting it in global scale, it accounts for 6% of the global total crude oil reserves (EIA, 2019a). Half of the reserves are located in the south of Iraq divided among five supergiant oil fields, each hold more than five billion barrels of oil reserves. The magnitude of oil reserves of Iraq including KRI, ranks the country as the second largest crude oil producer among the OPEC members, after Saudi Arabia. Crude oil export accounts for a significant proportion of Iraq’s GDP and the central government’s revenue. As illustrated in table 6, Iraq’s oil production was doubled from 2010 through 2018. Oil production in 2018 averaged around 4.6 million barrels per day, 90% out of this volume was produced under Baghdad’s control, in the south of Iraq. Three million bpd of the export encompass the Basrah Light which is mainly produced in West Qurna 1 Oil field in which

ExxonMobil is the lead operator. Iraq's economy is largely dependent on oil export. In 2017, oil exports with worth of \$60 billion structured 88% of the central government's revenue (EIA 2019b). In addition, Iraq is rich with natural gas reserves. With 3.82 trillion cubic meters of natural gas deposit, Iraq ranks the 12th richest natural gas holder in the world (EIA 2019a).

Table 6 - Iraq's oil production and its contribution to Iraq's GDP

| | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 |
|---------------------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| GDP (in US\$ billions) | 135.5 | 180.6 | 218 | 232.5 | 234.7 | 179.8 | 171.7 | 197.7 | 215.8 |
| Government oil revenue* | 40 | 46 | 43.4 | 39 | 36 | 27.5 | 23.2 | 28.8 | 34.1 |
| Oil production (mbpd) | 2.38 | 2.65 | 3 | 3 | 3.1 | 3.7 | 4.6 | 4.5 | 4.6 |
| Oil exports (mbpd) | 1.91 | 2.17 | 2.4 | 2.4 | 2.62 | 3.35 | 3.79 | 3.8 | 3.89 |
| Oil export prices (\$ pb) | 74.2 | 103.6 | 106.7 | 102.9 | 96.5 | 45.9 | 35.6 | 48.7 | 53.3 |

*In percent of GDP

Source: self-designed, extracted from IMF, 2019 Article IV Consultation with Iraq

KRI also possesses substantial quantities of energy reserves, “the largest remaining onshore oil frontiers” (Auzer 2017, 114). The Kurdish Ministry of Natural Resources estimates that KRI holds the world's 10th largest reserve of oil (45 billion barrels), in addition to 5.67 trillion cubic metres of untapped natural gas reserves (MNR 2013a). In October 2019, the total production and export of oil in Iraq (including KRI) was about 4.6 and 3.45 million bpd respectively. Kurdistan exported on average about 414,000 bpd in October 2019, which accounts for 12% of Iraq's total export (Oil.gov.iq 2019). In the last decade, three main fields in KRI has been explored by assistance of international energy corporations and has reached to production stage including Tawke, Taq Taq and Khurmala. All fields in KRI are easily accessible and onshore.

3.4.2. Energy transit infrastructure

Oil is transported by multiple means from southern and Northern Iraq to the international market. The oil pipeline network of Iraq is still being developed. The main export pipeline route for transporting the oil from the North of Iraq to the Mediterranean region was the Iraq Turkey Pipeline (ITP). The pipeline was constructed in 1970s based on an agreement between Turkey and Iraq with main purpose of transporting the Kirkuk oil to Ceyhan port in Turkey. The pipeline got seriously damaged in various sabotage attempts to the degree that building another pipeline was evaluated to be more economic. Currently, the only available option for Baghdad is using KRG's independent pipeline for exports from north of Iraq. As illustrated in table 7, the main operational oil pipelines are located in the north of Iraq. As presented in the , exports from the old Iraq section

of the ITP pipeline has stopped in the beginning of 2014 and was replaced by KRG's independent pipeline.

Table 7- Iraq's crude oil pipeline network

| Description | Pipeline Path | Location | Capacity (bpd) | Status |
|-----------------------------------|---------------------------------|------------------------|----------------|--------------------|
| Iraq- Turkey Pipeline (ITP)* | Fishkhabur to Ceyhan port | Southern Turkey | 1,500,000 | Operational |
| ITP - North Iraq | Kirkuk to Fishkhabur | Northern Iraq | 600,000 | Not Operational |
| KRG's Independent Pipeline** | Khurmala Dome - FishKhabur | Northern Iraq | 950,000 | Operational |
| Taq Taq-Khurmala pipeline | Taq Taq - Khurmala | Northern Iraq | 150,000 | Operational |
| DNO-KRG | Tawke field- Fishkhabur*** | Northern Iraq | 200,000 | Operational |
| Kirkuk-Banias/Tripoli pipeline | Kirkuk to Syria and Lebanon | Northern Iraq | 700,000 | Not Operational |
| Strategic Pipeline | Kirkuk to Persian Gulf | North to South of Iraq | 800,000 | Not Operational |
| Iraq Pipeline Saudi Arabia (IPSA) | Iraq to Saudi Arabia | Southern Iraq | 1,650 | Not Operational |
| DNO Peshkabir - FishKhabur | Peshkabir oil field- FishKhabur | Northern Iraq | 60,000 | Under construction |

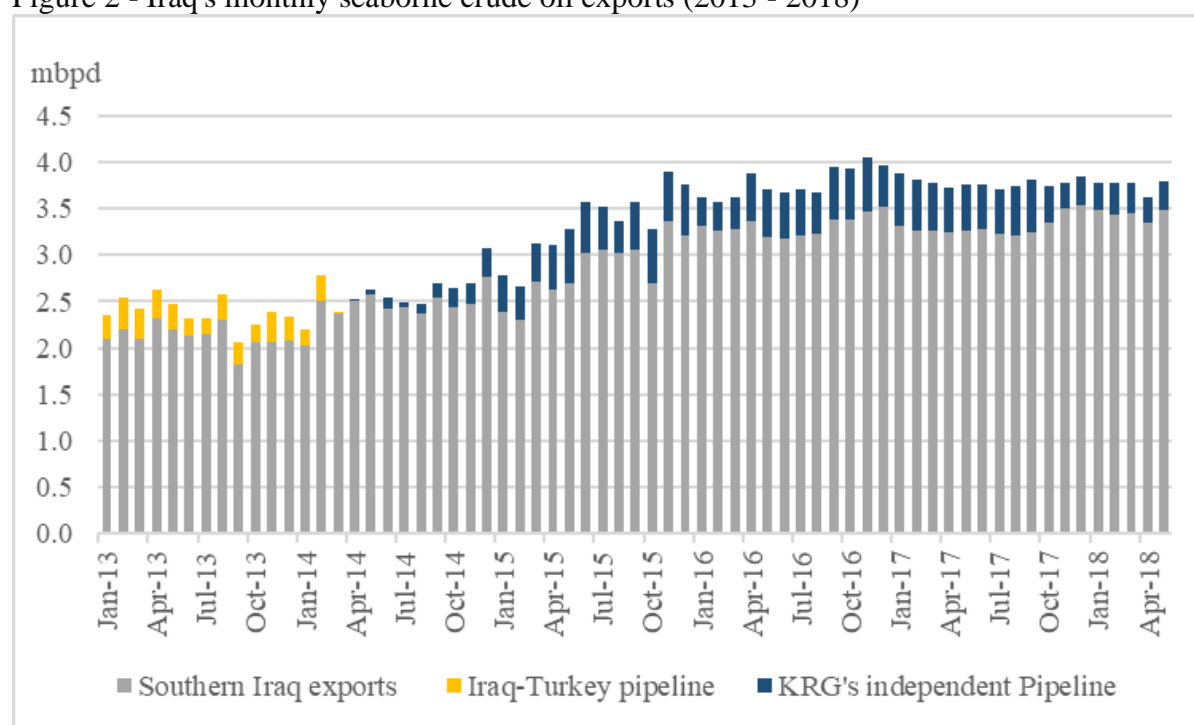
* Also called as Kirkuk-Ceyhan Oil Pipeline. The section of the oil pipeline pass through Turkey is the state-owned company, Botaş.

** Transports crude oil produced in Khurmala Dome and other near by oil fields such as Taq Taq.

*** Transports oil from Tawke oil field to Fishkhabur where it the pipeline joins the ITP.

Source: (EIA 2019c)

Figure 2 - Iraq's monthly seaborne crude oil exports (2013 - 2018)



Source: Self-designed, extracted from EIA database (EIA 2019a)

Oil exports are mainly occurring from the South of Iraq, via Persian Gulf. In 2017, 88% of the total export conducted in Iraq was by conducted by tankers which moved the crude oil to the ports in south of Iraq (EIA 2019a). Despite the fact that Iraq and KRI together possess one of the largest natural gas reserves in the world, but the amount of export of this product is zero due to weak or

almost non-existent natural gas transport infrastructure. For years, Iraq has relied on Iran to import natural gas for powering its electricity plants close to Baghdad (EIA 2019a).

3.4.3. Favorable petroleum fiscal regime

KRG has been trying to create a favorable investment environment and conditions for investment in the energy sector for the international companies. Policies, fiscal regimes and regulations designed by institutions define the business facilitations, restrictions, risk associated to FDI, and profit opportunities in the host countries. This section sheds more light on the governance structure of the oil and gas industry in KRI and the fiscal arrangements between the international energy companies and KRG under PSCs legal designs. It is important to make it clear where the federal laws coverage of the international investments and tax regulations ends and where that of KRG's starts. For this reason, a brief overlook of Iraqi constitution (2005) and the draft of federal oil and gas law of Iraq is provided.

The constitution of Iraq was rewritten in 2005, which reshaped the political structure of the country based on republic and federal system (Article 1, Iraqi Constitution). Since the constitution came into force, the Kurdistan Region of Iraq has been recognized as a "federal region" (Article 117 (1), *ibid*). Governorates or provinces of Kurdistan of Iraq are known as Dihok, Erbil, Suleymanieh and Halabchah. Article 140 of the Iraqi Constitution has foreseen a referendum for concluding the future of the disputed territories including the hydrocarbon-rich region of Kirkuk. A legal consideration which supposed to be put into forth in 2007, a promise which has never been realized.

Articles 111 and 112 of the Iraq constitution cover the regulations related to the ownership, management and policy making of the natural resources in Iraq (including KRI). Article 111 refers to the initialization of the oil and gas wealth of Iraq by stating: "Oil and gas are owned by all the people of Iraq in all the regions and governorates" (Article 111, Iraqi Constitution 2005). Regarding the management, the Iraqi Constitution proposes: "The federal government, with the producing governorates and regional governments, shall undertake the management of oil and gas extracted from present fields" (Article 112 (1), *ibid*). The Constitution introduces both the federal government and the regional and governorates as eligible parties for designing and formulating the strategic policies related to the oil and gas resources (Article 112 (2), *ibid*).

The draft of federal oil and gas law of Iraq was published in February 2007. The draft failed to gain the approval of the majority of the parliament members of Iraq. So far, Iraq lacks a federal-approved oil and gas framework. By constitution, KRI was given partial control over its natural resources and economic sovereignty. Two main legal frameworks regulating the foreign investment in oil and gas sector of KRI are: Kurdistan Region Investment Law (passed in 2006) and KRG's Oil and Gas Law (enacted in 2007). In accordance with the Kurdistan Region Investment Law, the Investment Board in KRI was established as the body responsible of managing, stimulating and boosting investment in the region. The body responsible for regulating, licensing and supervising upstream and downstream operations conducted by national and international entities in the KRI territory is the Ministry of Natural Resources.

The fiscal arrangements between KRI and the international companies are mainly based on the production sharing contracts regulated under KRG's oil and gas law. In comparison, the main characteristics of the federal oil and gas law draft was its insistence on Technical Service Contracts (TSCs) rather than Production Sharing Contracts (PSCs). Despite Baghdad's disagreements, KGR has signed 60 PSCs with international hydrocarbon companies since 2007 (MNR 2020). The main factors determining the profitability of a PSC are the associated exploration risk, royalty cost, cost recovery oil, profit oil and tax arrangements. In the following the characteristics of the PSC models in KRI is discussed.

Article 43 of the Oil and Gas Law of KRG appoints KRG's minister of natural resources as the main authority of determining and regulating the terms and conditions of the oil and gas contracts with the international energy companies. PSC is one main form of contracts suggested by the second provision of the article 24. However, the article does not recommend clearly any other form of contracts, but it appoints the minister of natural resources as the authority who could decides about other types of contracts to be signed with the international companies.

KRG's policy has been to create a "modern, progressive and investor-friendly petroleum regime" (MNR 2013c). PSCs signed between KRG and international companies are confidential documents. However, Ministry of Natural Resources provided a Model PSC as a reference (MNR 2013b). In addition, chapter ten of the KRG's Oil and Gas Law specifies general terms and conditions of PSCs. The initial exploration term offered under a PSC would be five years, with the possibility of extending it up to seven years. During this period geological and scientific

assessments and seismic studies of the fields are completed and usually two exploration wells are drilled. If this stage does not reach to commercial discovery the expenses and costs will not be reimbursed to the international company. If the exploration results in a discovery, the contractor could be granted a twenty-year development term. This period could be extended to a further five years or other negotiable longer periods. In case of commercial discovery, the international company is required to pay 10% royalty of gross total production of crude oil production and non-associated natural gas. A production bonuses is also will be paid to the host country. In return, at the point that the commercial production is started the international company is entitled to recover all petroleum costs incurred which encompass decommissioning costs, exploration costs, production costs and development costs. This amount is taken in form of a portion of the petroleum production; however, the contract puts a cap of 45% and 60% limits for crude oil and gas, respectively (KOGIL 2007, article 37 (6)). The remained is profit which is allocated between the international company and the host country based on a “R” factor, explained in the PSC model. R factor is a ratio of cumulative oil revenues obtained by the international company (petroleum cost and previous actual oil profits) divided by cumulative actual petroleum costs incurred from the signature of the PSC (MNR 2013b, article 26.4). In case the ratio is less than one then the project is at pre-production stage in which the international company is handling all costs and expenditures. Once the ratio is larger than 1 but lower than 2, then the production stage has started, and the profit split is 30/70% in favour of KRG. At the point the ratio exceeds 2, the profit split proportion changes to 15/85% in favour of KRG (ibid).

Kurdistan Region Investment Law proposes tax and customs exceptions to national and international companies. Article five (provisions 1 to 6) of this framework law proposes exemption of non-custom tax payments for ten years from the point the company starts production or rendering services in KRI. In addition, machinery, equipment and tools imported to KRI to be used exclusively in the project are exempted from tax and customs duties charges. KRG’s Oil and Gas Law, article forty mentions that there may be tax exemption considered for petroleum related contractors by law. The same article also states that a contractor associated with “petroleum operations is liable for any applicable taxes of the Regional Government, including: 1) surface tax; 2) personal income tax; 3) corporate income tax; 4) customs duties and any other similar taxes; 5) windfall profits or additional profits tax; and 6) any other tax, levy or charge expressly included in its Petroleum Contract” (KOGIL 2007, 20). Oil and gas companies are subject to corporate income

tax on the income generated from their petroleum operations in KRI. KRG has been charging international companies with production sharing contracts at flat income tax of 15% (EY 2019). International oil and gas companies are charged at 35% corporate income tax rate in the rest of Iraq. In the following table, royalties and tax rates under PSCs in some other countries are provided for comparison. In case of Royalties, it could be seen that KRI, charges the maximum cap, however, tax rates under PSC Model of KRI could be seen as attractive.

Table 8 - Countries with PSCs

| Countries | Royalties (%)* | Tax rate (%) |
|------------|----------------|--------------|
| Brazil | 5 to 10 | 34 |
| Cyprus | 0 | 12.5 |
| Malaysia | 10 | 38 |
| Oman | 0 | 55 |
| Ukraine | 1.25 or 2 | 18 |
| Uzbekistan | 0 | 12 |

* Royalties are paid as % of gross production

Source: Global oil and gas tax guide (EY 2019)

One advantage associated with the KRI's PSCs is the fiscal stability clause which reduces the uncertainties related to unexpected increase in tax rates and variety of other risks associated with changes occurred within the host country's regulations. Article 43 holds government responsible for maintaining "stability of the fiscal and economic conditions" (PSC Model Article 43 (3)) of the PSC. Article 43 (4) of the PSC Model provides the international company with negotiation rights, in case the changes in the host country's regulations, fiscal order, or economic system has "detrimentally" impacted the entity.

3.5. Internalization-specific advantages

"Internalization-specific advantages" outline the motives behind a firm's entry mode to a host market. As articulated by Dunning's OLI paradigm, with presence of (O) and (L) advantages, a company may decide to internalize the process of exploiting the (O) advantages. This decision is reflected in its entry mode. In the previous section, it was explained that the dominated form of entry mode in the energy sector of KRI is through PSCs. Nationalistic approaches in many OPEC countries including Iraq, advocates non-equity modes of entry for international companies rather

than allowing greenfield FDI or setting up subsidiaries in the host countries (Kojima 1982, 16). Non-equity modes of entry encompass contractual arrangements such as PSCs and service contracts (ibid), dominantly used by KRI and Baghdad, respectively. Gazprom and Rosneft have decided to exploit their ownership advantages internally, through PSCs, the dominant form of contractual arrangement for international companies in the energy sector of KRI. Both companies exploit their ownership-specific advantages according to the terms and conditions stated in the contracts. This works in advantage of Gazprom and Rosneft. As explained by Kalotay (2010, 24): internalization of foreign activities through strategic alliances and non-equity forms of investments save international companies from risks and costs associated with acquiring assets overseas. The following indicators provide better understanding regarding Gazprom and Rosneft's internalization advantages by engaging in energy sector of KRI:

3.5.1. Access to oil supplies and favorable oil prices

Due to years of political tensions between KRG and the central government in Baghdad, periods of economic downturns and the ambition of reaching to economic independency in separation from Baghdad, for many years Kurds were trying to sell the crude oil at lucrative discount rates. In 2016, KRG exported 564,700 bpd of crude oil independently from Ceyhan port in Turkey at total price of \$636 million which indicates a discount rate of \$7 when compared to Brent prices at the same period (Iraq Energy Institute 2018, 39). From 2017, with KRI losing control of Kirkuk to the central government and due to the uncertainties around legality of oil purchases from KRG without consent of the central government in Baghdad, the region's crude oil has been traded with average discount of \$10 per barrel (ibid, 50). In addition, exploration and production costs are significantly low in Iraq as well as KRI. Genel Energy, a British based energy company which operates in KRI (Taq Taq, Tawke, and Peshkabir oil fields), reports a fast rate of return and low cost on its assets invested in KRI. Company's estimations predict a \$3 cost of production per barrel of crude oil for 2020. A study conducted in 2015, predicts exploration costs of \$0.27 per barrel for Rosneft as well as \$2.42 and \$3.69 production costs for Gazprom and Rosneft in KRI respectively (Aublinger 2015).

In the next section, a conclusion will be made of economic motives behind Russian state-owned companies' expansion into KRI. The independent variables and related indicators were observed the possibility of motives to fall under natural resource seeking classification.

3.6. Resource seeking motive of Gazprom and Rosneft in KRI's energy sector of KRI

Findings of the previous sections support the first hypothesis which was seeking for economic motives behind Gazprom and Rosneft's expansion in KRI. The best motive that could explain Gazprom and Rosneft's OFDI is Resource seeking incentives, as the independent variables presented in the methodology chapters were observed (table 9). Gazprom is engaged in upstream projects, while Rosneft shows more interest in engaging in both upstream and midstream projects in KRI. The head of Rosneft commented on the first cooperation agreement signed between KRG and Rosneft in 2017, pointed out at the importance of the agreement for "developing new markets worldwide for Kurdish crude oil. The off-take and supply of Kurdish crude oil into Rosneft's expanding worldwide refining system will further contribute to the increase in its effectiveness" (Rosneft, 2017e).

Table 9 – Observation results for resource seeking motive

| Specification | Independent variables | Indicators | Results |
|--------------------------------|------------------------------------|---|--------------|
| Resource-Seeking Motive | Ownership-Specific Advantage | Access to markets | Observed |
| | Ownership-Specific Advantage | Revenue and capital | Observed |
| | Ownership-Specific Advantage | Technology | Not observed |
| | Location-Specific Advantage | Availability of oil and gas resources | Observed |
| | Location-Specific Advantage | Energy transit infrastructure | Observed |
| | Location-Specific Advantage | Favorable petroleum fiscal regime | Observed |
| | Internalization-Specific Advantage | Access to oil supplies and favorable oil prices | Observed |

Source: self-designed - Dunning and Lundan (2008)

Both companies have the ownership advantages to expand overseas. Technology advantages in relation to exploration and production operations was the only indicator which was not observed. This was due to the fact that KRI's oil and gas fields are onshore and far from complexity. International companies do not compete with each other based on advancement of their technologies. For Gazprom, the low cost of exploration and production operations in KRI seems to be a more attractive factor. In case of Rosneft, more ambitious agenda could be seen.

Rosneft has heavily invested in downstream business. In Russia it possesses 13 major refineries with capacity of 118.4 million tons per year. This amount accounts for 35% of overall refinery activities in Russia. Rosneft possess assets in refinery businesses in Belarus, Germany and India. KRI's oil output have an important role in securing supply of refineries in Germany and India, in which Rosneft possess interests. The importance of assets hold in refineries for Rosneft could be sorted based on their refining capacity: India, Germany and Belarus possess the capacity of

refining 20, 11.5 and 2.1 million tons of crude oil per year (Rosneft 2020a). As a vertically integrated company, having a foothold in the oil rich Kurdistan could assist Rosneft to manage the international flow of crude oil to its customers and refineries. In the tenth Eurasian Economic Forum which was held in Verona, Italy, in October 2017. Igor Sechin, the head of Rosneft stated: “we are very serious about working in Kurdistan and Iraq. Our interest in these projects is purely practical - this region features the largest resource base with low production cost and potential that is not fully disclosed yet. It is very important that the oil from Kurdistan goes directly to our refineries in Germany. At the same time if we include this region in the sphere of Eurasian business integration, we will contribute to solving general economic and social tasks - energy stability and advance in living standard” (Rosneft 2017e). In the same forum, Sechin talked about Rosneft’s interests with engaging in upstream projects in other countries in the West of Asia including Iran and Saudi Arabia. The main interest is pointed out as: “to establish effective supply chains of Iranian and Central Asian oil to the world market”. Rosneft is based in Russia, an energy rich country, however, investing in other energy supplier states is not a foreign strategy for the company. Rosneft has been trying to secure its energy supply chain by investing in different energy countries including Venezuela. Investing in the energy of Kurdistan could be seen as hedging against risk associated with other investment or the possibility of interruptions with the crude oil supply from the energy market at a desirable price.

In the same year that Rosneft started strengthening its foothold in the north of Iraq, it got engaged in downstream businesses in other countries including India and Germany. Rosneft expansion in KRI is partly for the purpose of diversifying and securing the supply of crude oil to Rosneft’s refineries in Germany and India. The KRI energy sector was assessed strategic -even on paper- for the Rosneft decision makers as they put massive effort, politically and economically to keep a foothold in the region. Rosneft have already invested \$3 billion in KRI in addition it has made \$250 million payment between 2017 and 2018 to an external consultant in order to make the agreements with KRG secure. In addition, Rosneft has established five subsidiaries in Singapore for developing PSCs in KRI.

In August 2017, PJSC Rosneft and a consortium comprised of Trafigura Group Pte. Ltd. and UCP acquired 98.26% stakes of the Essar Oil Limited in India in exchange for \$12.9 billion. The acquired assets include an oil refinery in Vadinar, retail network of petrol stations (2,700 at the

time of acquisition expanded to 5,000 fuel-filling stations in 2019), infrastructure for storage, import and export of oil. Rosneft's share stands at 49.13%. In 2019, Essar Oil Limited was rebranded to Nayara Energy Limited. The acquisition was made possible due to the initial owner of Essar Oil Limited, the Essar Global's large sum of debt of \$500 million. Rosneft and Essar's history is longer than the acquisition. In December 2014, Igor Sechin signed a deal with the company for supplying crude oil to the refinery in presence of heads of both countries India and Russia, Modi and Putin. The agreement required Rosneft to supply 100 million tons of crude oil to the Vadinar refinery for ten years period, starting from 2015 (Rosneft 2014). Vadinar refinery is the second largest refinery in India with capacity of refining 20 million tons of light to extra heavy crude oil per year (400,000 barrels of crude oil per day). This accounts for approximately 8% of India's refining capacity. The majority of crude oil supply imported to India pass through the Vadinar refinery, which could reach up to 70%. The Refinery benefits from a fully integrated infrastructure encompassing a port with access to deep waters, tankers, pipelines; in addition to an oil terminal with capacity of 58 million tons per year. Acquisition of Essar has strategic advantages for Rosneft, among them access to the market of Asia-Pacific region and South-East Asia. The acquisition Essar Oil Limited was completed after Rosneft's advance payment for the supply of the KRI's crude oil for the period of 2017 to 2019.

In addition, Rosneft possess shares in three refining companies in Germany: MiRO GmbH & Co. (24% of shares), BAYERNOIL Raffineriegesellschaft mbH (25% of shares), and PCK Raffinerie GmbH (54.17% of shares) (Rosneft 2020a). As it was marked previously by Igor Sechin in the tenth Eurasian Economic Forum, KRI's oil is important to be supplied directly by refineries in Germany. (Rosneft 2017e). In April 2017, Rosneft received a shipment of 600,000 barrels of KRI's crude oil to its refinery in Germany. The next shipment was transferred to the Vadinar refinery in India (TASS 2017). With assets in refineries in different parts of the world, it becomes important for Rosneft to secure an efficient supply chain of crude oil to these facilities. KRI's oil resources and its geographical location provides a great opportunity for Rosneft to diversify and secure supply of crude oil for Germany and India.

3.7. Home country factors

OLI Model is more concerned with explaining economic motives of companies' FDI outflow. In comparison, the "home-country factor" and neomercantilism propound more forces behind

companies' FDI. Combining "home-country factor" introduced by Kalotay (2010) and neomercantilism approach generate indicators that are presented under the same name as an independent variable: first, expanding overseas for Russia's economic goals and second, expanding overseas for Russia's political goals. The first indicator may overlap with, company's commercial and economic objectives, however the difference relies on the fact that the decision-making bases is beyond the firm's management level, and more falls in hands of the state, national and international policies designed by the state. The following indicators will be explained together, as some overlapping of data exists.

3.7.1. Expanding overseas in line with Russia's economic goals

3.7.2. Expanding overseas in line with Russia's political goals

The Energy Strategy of Russia up to 2030 is an official document designed by the ministry of energy of Russia. The document was approved by the government of the Russian Federation in 2009. The Energy Strategy of Russia up to 2020 was the former version of the document which was approved in 2003. The document outlines Russia's long-term development objectives, priorities and strategies for the period of 2010 to 2030 (ES-2030, 2). The main objectives of the strategy are determined as: "to maximize the effective use of natural energy resources and the potential of the energy sector to sustain economic growth, improve the quality of life of the population and promote strengthening of foreign economic positions of the country" (ibid, 10). The document outlines a set of strategic objectives as Russia's "foreign energy policy" addressing the requirements for securing a desirable position in the global energy competition. The main goal could be pointed as "maximum efficient use of the Russian energy potential for full-scale integration into the world energy market" (ibid, 55). Russian energy companies play a vital role in strengthening the position of Russia in the international market. As it is pointed out in the document: "enhancement of leading Russian energy companies' positions abroad" assist with achieving "the strategic objectives of the foreign energy policy" (ibid, 57). The road map included in the document suggest that regional cooperation with economies such as the Middle East could assist with strengthening the position of the Russian energy companies and promoting the Russian enterprises' interests in the international market. Other targeted markets are suggested as Africa, China, Latin-America, European Union and Asia-Pacific. This regional cooperation could be in form of "development of mutually beneficial exchange of energy assets" (ibid, 168). Cooperation with governments in different regions is seen as a great opportunity for the Russian energy

companies to pursue their interests which could be increasing their project management capabilities and technological skills. To sum up, the energy strategy of Russia expects an active role in the global chain of energy supply, securing energy revenue, and increasing the opportunity of exporting hydrocarbon-related services and technologies. Russian companies' expansion in the international market and their integration into different regional markets will assist Russia to gain this goal.

Regarding Russia's priorities in its international economic relations, in the 2008 Concept, it is determined that Russia is interested in securing a strong and equal position in the global economy (RFPC 2008; RFPC 2013; RFPC 2016). The concepts emphasize on the importance of advancing and modernizing the energy industry of Russia. The Concept recognizes a modern and advanced Russian energy industry vitally important for Russia in gaining a desirable reputation in the international market based in its capabilities in the energy industry (RFPC 2008). The explicit reference to the energy sector vanished from the newer versions of the Concept since the focus shifts to diversifying the Russian economy and decreasing its reliance on the energy sector. All concepts point out to the importance of the energy security through the means of international market, trade and transit routes. In addition, the Concepts refer to the state as the main supporter of Russian companies which expand to new markets or protect their share in the existing market (RFPC 2008; RFPC 2013; RFPC 2016). In all three documents, Russia signals interest in engaging in the Middle East at both political and economic levels. As a member of United Nation Security Council and as a member of the Quartet of international mediators, Russia shows willingness to secure a place for participating in or supporting collective initiatives for stabilizing the Middle East by taking actions in relation to the Palestine-Israel conflict, Islamic extremism or spread of illegal weapons.

The National Security Strategy to 2020 was published in May 2009, which mainly portrays Russia's perception of national and international threats. The document states a series of potential political, military and economic measures in response to the threats against Russia's national interests. The document portrays Russia as a country which has restored its "potential to enhance its competitiveness and defend its national interests as a key player within evolving multipolar international relations" (NSS 2009, provision 1).

Sustainable economic development, national defense, in addition to state and social security are the three critical domains of focus under Russia's state policy and national security strategy. The ultimate goals are addressed in the document as transforming Russia into a world leader in different aspects including life quality, technological advances and sustaining a key role in influencing the global affairs (NSS 2020, provision 1). The national interests of Russia are enumerated as positioning Russia as a world power in addition to enhancing "the competitiveness of the national economy" (ibid

, provision 21). The strength of the national economy is outlined as the main contributor to Russia's national security (ibid, provision 15). Modernizing and developing certain sectors including the financial and energy sectors are stated as elements improving the economic strength (ibid, provision 54). Improving Russia's GDP in order to reach the top five economies in the world is a suggested mean for affirming Russia's economic growth (ibid, provision 53).

The document points out a series of issues associated to the modern world in era of globalization, among them the competition over ownership of natural resources is mentioned. Regional conflicts and military operations are enumerated as a disruptive factor in the energy ownership and supply and consequently a damaging factor over global economy (NSS 2020, provision 12). As the main focus and importance is set on the energy sector as the main driver of Russia's economic growth, the document outlines dependence on raw material export as a threat to the national security of Russia (ibid, provision 55). The other national security threats at economic level are enumerated as reduction in competitiveness of the Russian companies, lessening of sovereignty over Russia's national resources, deterioration of Russia's financial system, low quality of domestic business environment and disruptions in access to natural resources (ibid). Energy security has a critical weight in Russia's national security at economical level. Sustainable supply of energy, competitive energy companies, obtaining market shares for energy products are among the main components mentioned in the document (ibid, provision 60).

To sum up, Russian state-owned companies' expansion abroad driven by economic goals such as:

- 1) Economic growth of Russia
- 2) Sustaining a strong position for Russia and Russian in the global economy

It could be concluded that Russian State-owned companies' expansion abroad driven by political goals such as:

- 1) National security through strong energy revenue, sustainable supply of energy, and access to energy transit routes
- 2) Securing an influential position for Russia in international affairs
- 3) Achieving strategic objectives of the foreign energy policy

3.7.3. Gazprom and Rosneft's operation's in KRI in perspective of Russian policies and home-country factors

Russian policy makers seek a more desirable position for Russia in the global economy and international affairs. The desirable position, in different documents, is referred to as a global power, world leader, influential in political affairs and economic leader. In order to achieve any of which, Russia needs a robust economy mainly based on its energy sector.

“Location-specific advantages” of KRI serve the economic and political goals of Russia. Rosneft and Gazprom have invested in exploration and production projects in KRI. In addition, Rosneft has secured its ownership over the major export oil pipeline in the north of Iraq. Rosneft has also its hands on the future export gas pipeline in the north of Iraq, which could assist with controlling the natural gas flow into Europe and other markets. Since the project is not started, this potential foreign policy instrument will not be discussed further. Rosneft's PSCs and its pipeline projects have not financially realized, for this reason their commercial contribution to the economy of Russia cannot be assessed. However, it can be seen that Rosneft has kept a foothold in KRI with all the projects, with their commercial fates to be determined in the long-term future. Rosneft has been contributed to Russia's revenues by the advance payment contract. Gazprom profited through the Garmian oil field project. It would be difficult to explain the contribution with quantitative data since KRG and both state-owned Russian companies are not transparent and detailed in their transactions and contractual arrangements. However, based on the discounted oil prices and cheap exploration and production cost in KRI, it could be assumed that engaging in projects in KRI are profitable. Meanwhile, both companies boosted their access to oil supplies in foreign market extra to the Russian domestic productions.

The economic objectives of Gazprom and Rosneft in the KRI to a great deal has been in accordance with Russian state's economic policies, however, in some cases it was contradicting them. In accordance with the policies, Gazprom and Rosneft succeeded in expanding in new markets, got engaged in cooperation which promotes Russian companies' reputation and capabilities and

securing access to crude oil supply. However, the production sharing contracts signed with KRG has been in conflict with constitution of Iraq. Another contradiction could be seen in Russian officials and heads of Rosneft's discourses and their way of handling the matters related to the Kurdish independence referendum, while there were investment opportunities arising in KRI.

Prior to the referendum, Rosneft engaged in exploring the possibility of investing in oil fields under control of KRG but some located in the disputed territories. As stated by Rosneft' representatives, they were interested in commercial relationship with both Baghdad and KRG as stated: "If the Iraqi government offers us projects on conditions that will be commercially acceptable for the company and adequate to the market, we will be interested to consider them" (Sheppard and Foy 2017a). However, in the end Rosneft shifted to KRG because of the better offers provided by them (ibid). In September 2017, a referendum was held in KRI organized by Masoud Barzani, the former president of KRI with purpose of deciding about the independency of the region from the rest of Iraq. The referendum's outcome was in favor of independency with the majority of votes of 92,7%. Referendum was opposed by Baghdad, Iran and Turkey. Prior to referendum, all three announced countermeasures they would take against KRI ranging from sanction to military intervention. Major power including European countries and the United States opposed the referendum results. The referendum was not a sudden plan. In February 2016, Barzani announced the intention of holding a referendum on independence. Few months later, in an interview Evgeny Arzhantsev, the deputy consul general in KRI stated: "I think Moscow will support the decision made by the people of Kurdistan because it is a decision through referendum how can you not listen to what people's choice is" (Goran 2016). He also added: Russia is seeking for "good and permanent political relationship with the leadership of Kurdistan" (ibid). Almost a week prior the referendum, Sergei Lavrov, the foreign minister of Russia stated: "We are interested that the Kurdish people like any other nation on the planet can fulfill its hopes and aspirations...the legitimate aspirations of the Kurds, like other peoples, need to be fulfilled within the framework of existing international legal norms" (Zhdannikov 2017). After the referendum, with the tensions increased between the neighboring countries allied with Baghdad against KRG, Russian officials acted more as of a deescalating party rather than questioning or rejecting the Kurdish authorities. It was a month later than the referendum that Rosneft's took over 60% control of the major oil pipeline in the north of Iraq, with an agreement with KRG. Rex Tillerson, United States Secretary of State declared a position against the referendum results by stating: "The vote and the results lack legitimacy and

we continue to support a united, federal, democratic and prosperous Iraq” (Qiblawi et al. 2017). Few days after the referendum, Iraqi forces advanced into the strategically important territories, including Kirkuk in the north of Iraq and took the control from Peshmerga. KRG faced punitive measures from Baghdad Iran and Turkey, including suspension of international flights to and from KRI. Meanwhile, Igor Sechin, the head of Rosneft was engaged in taking control of the KRG’s independent oil pipeline.

In the beginning of October 2017, amid post-referendum tension, Baghdad accused international companies operating in KRI under contracts signed bilaterally with KRG of breaching the international law. The Iraqi Oil Ministry demanded more clarification on Rosneft’s projects in KRI, which was responded by Mikhail Leontiev, Rosneft’s representative that the company is “not liable to report to anyone” (Foy and Sheppard 2017b).

Kurdish independence referendum also included the oil rich Kirkuk region, one of the recognized disputed regions in the Iraqi constitutions. The region was under control of KRG since 2014, when the Peshmerga forces took the regions from Islamic State. KRG was enjoying independently, exporting the oil of this region. With Kirkuk oil reserves out of hands of KRG, on average 300,000 bpd of export output were vanished (Foy and Sheppard 2017b). With this reduction in the amount of crude oil available to KRG, the officials faced critical issues with repaying Russia’s advance payment in kind. For this reason, the remaining balance of debt which supposed to be cleared in remaining two years was converted into a 60% stake of the KRG’s independent oil pipeline during the referendum uproars. In October 2017, Rosneft signed five PSCs with KRG a party that offered “a higher interest in expanding strategic cooperation” (Zhdannikov 2018) in comparison with Baghdad. Control over the oil pipeline had mutual benefit for both KRG and Rosneft. There has been a long conflict over budget allocation between KRG and Baghdad over the last decade. Based on current agreement, Baghdad pays KRI’s employees in exchange for 250,000 bpd, an obligation which has not been met by KRG. Rosneft backed KRG in the claim that the crude oil transportation to Baghdad will be done only if Baghdad pays Rosneft the pipeline transit fees and legality PSCs signed with KRG are approved (Watkins 2019).

Rosneft’s actions in Iraq, slightly contradicts with Russia’s foreign policy when it comes with deteriorating relationship with oil producer countries Iran and Iraq and Turkey as the transit country and importer of energy. In addition, the referendum which was not stopped by Russia and

indirectly funded by Rosneft increased the tensions in the region, which consequently disrupted the oil production and transportation. The Kirkuk outlet which was transported to Mediterranean via Turkey was halted for almost a year starting from October 2017, which resulted in 60% drop in seaborne exports, equivalent of 214,000 bpd in October 2017. The other result of tensions was the spike of Brent crude oil prices to over \$60 a barrel, the highest level in two years (EIA 2018).

Moreover, external influence in the referendum could be interpreted as violating Iraq's territorial integrity and sovereignty. Russia may have lost a secure and constant flow of crude oil from Kirkuk oil fields, but in other hands it got access to the major oil pipeline in the North of Iraq on KRI's territories, a possibility of controlling the future gas pipeline to Turkey, in addition to five PSCs for exploration and extraction of crude oil in KRI and also in the disputed territories in the north of Iraq. At the same time, Rosneft's operations in KRI are serving Russia's economic foreign policy since it strengthens Russia's geological position in the Middle East and as a main supplier of crude oil and natural gas to Europe and East of Asia.

Rosneft cemented its presence in the economic and political space of Iraq. With all the disagreements from Bagdad, in 2018, Rosneft was approached by Jabbar al-Luaibi, the former minister of oil of Iraq for construction of a pipeline in replacement of the damaged section of the Iraq Turkey Pipeline. Iraq needed to restart productions in Kirkuk and as stated by the minister that the Iraqi side "does not object if Rosneft wants to expand its work to include all the fields of Kirkuk, after the coordination with BP" (Graeber 2018). In addition, the minister declared that "Rosneft is important because it owns 60% of the Kirkuk-Ceyhan pipeline, and we want to use this pipeline" (Younis 2018).

In the beginning of October 2019, Sergei Lavrov, the foreign minister of Russia, had an official visit to Baghdad and then to Erbil. This was the first visit of a top Russian official to the Kurdistan region of Iraq. The visit was done at the time when Iraq was struggling with anti-government protests. During this period Russia kept its embassy open in Iraq. In Baghdad, Lavrov met with Mohamad Ali Alhakim the foreign minister of Iraq. The main topic of discussions was Syria, terrorism, freedom of navigation in the Persian Gulf and Iraq's readmission to the Arab League. In Erbil, the delegation met with Nechirvan Barzani the president and Mansour Barzani the Prime Minister of KRI. Lavrov was accompanied by a delegation composed of businesspersons rather

than diplomats. Among them representatives of Technopromexport (an engineering company engaged in building power plants), Gazprom Neft, Rosneft and Soyuzneftegaz (Belenkaya 2019).

Referendum and the Kurdish debt gave an opportunity to Rosneft to take ownership in the Kurdish oil pipeline. This assisted the Kurds to independently export their oil without through KRG-controlled territory Baghdad's consent. The Kurdish export pipeline was completed by KRG in 2013. The pipeline connects Taq Taq field to the Turkish border where it joins the old construction of Iraq-Turkey pipeline. The Iraq-Turkey pipeline was built in 1976 was damaged massively and Iraq has been exporting ineffectively from it. The pipeline connecting Kirkuk oil fields to Turkey has not been built yet. Considering the fact that building 1000 kilometer of pipeline to Turkish border from Kirkuk will take at least few years. This shows that Rosneft will have higher leverage over Baghdad. In addition, Iraq is still facing security and financing issues, for these reasons the fate of the project is very vague.

Findings support the second hypothesis. Russian state-owned companies' expansion in KRI is in accordance with the national and international policies of the state. The operations in KRI are more concerned with strengthening the Russian economy and securing access to crude oil supply and the energy transit routes.

Conclusion

The main objective of this thesis was understanding the economic and political determinants behind Russian state-owned expansion in Kurdistan region of Iraq (KRG). OLI model was employed for analyzing the economic motives at the firm level, while neomercantilism approach and home-country factors were synthesized in order to help with capturing the whole image of decision-making forces impacting Russian oil and gas companies' foreign direct investment. The role of Russian state in directing expansion of strategically important companies such as Rosneft and Gazprom was taken into consideration. The theoretical approaches assisted with generating a set of independent variables and related indicators with impact on the dependent variable. In the next step, hypotheses were developed to assist with the analysis and further investigations addressing the research question:

“What are the main economic and political incentives behind the Russian state-owned energy companies' OFDI in KRI?”

Two Russian-state owned companies engaged in the oil and projects in the north of Iraq were observed were Gazprom and Rosneft. Based on the OLI Model, the best motive that could explain Gazprom and Rosneft's OFDI in Kurdistan Region of Iraq's energy sector found to be natural resource seeking incentives. Kurdistan region of Iraq attracted both companies due to its large resource base, possibility of export energy through Turkey and south of Iraq, and the low cost of exploration and production operations. In addition, the region offers oil at large discounted price. Rosneft was observed to have more ambitious agenda in the region in comparison with Gazprom. Rosneft succeeded to take ownership in Kurdistan's main export oil pipeline to Turkey and from there to Mediterranean Sea. Rosneft possess assets in refineries in India and Germany, which has made it important for Rosneft to secure an efficient supply chain of crude oil to these facilities. KRI's oil resources and its geographical location provides a great opportunity for Rosneft to diversify and secure supply of crude oil for Germany and India. Control over the international flow of crude oil could assist with meeting the contracts signed with consumers as well as keep the business running. Having a foothold, in different oil rich companies could be interpreted as hedging against risk associated with the possibility of interruptions with the crude oil supply from the energy market at a desirable price.

Findings regarding the home-country factors shows that the economic objectives of Gazprom and Rosneft in the KRI have been in accordance with Russian state's economic policies.

Overall, the policies seek for a stronger political and economic position for the state through the energy companies. Russian state-owned companies' expansion abroad driven by economic goals including strengthening the Russian economy in the global market while generating sustainable revenue for the state. It could be concluded that Russian State-owned companies' expansion abroad driven by political goals. These goals include securing revenue sources for Russia, securing the energy flows and energy routes. Ultimately, Russian companies are expected to assist the state in securing an influential position international affairs and also achieving strategic objectives of the foreign energy policy.

In accordance with the national and international policies designed by the state, Gazprom and Rosneft succeeded in expanding in new markets, got engaged in cooperation which promoted Russian companies' reputation and capabilities and secured access to crude oil supplies and energy transits. Rosneft had a bolder presence in comparison with Gazprom. Rosneft has been capitalizing on its energy partnership with the authorities of KRG for achieving economic goals which is in accordance with natural resource seeking motives at the firm level as well as it follows the overall policies of the state. However, if we take neomercantilism views into consideration then it could be seen that robust economic position is correlated with stronger political position. For Rosneft, KRG possess locational advantages which are controlled by authorities in distress who are in need of foreign support both financially and politically. This could be seen as an additional location-specific advantage. Rosneft acted as a funder to KRG during the economic downturn and political unrest and there was a particular assistance in relation to the independency referendum in 2017. It could be argued that KRG was into more distress after the referendum, as situation which assisted Rosneft to turn a portion of the debt that KRG was not able to pay into a share of the major crude oil export pipeline in the north of Iraq.

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