Cooperation and Conflict in Oil and Gas Markets

Dag Harald Claes

Introduction

There are a number of factors influencing the developments of energy industries and markets. In the hydrocarbon age the physical availability of coal, oil, and gas resources is a fundamental condition for energy production and consumption. The choice of energy among individual energy consumers worldwide and the elasticity of their demand forms another condition for energy producers. However, to large extent, the development of the international oil and gas industries and their respective international markets has been formed through cooperation and conflict among key political and commercial actors. This is the topic of the present chapter. It is impossible to cover all aspects of all energy sectors. Today, the emerging renewable energy sectors gain importance and political attention on many levels. They will not be part of this chapter but are dealt with elsewhere in this volume. This chapter will focus only on the international oil and gas markets.

The chapter is split in two parts. The first one is historical and confined to past cooperation and conflicts in international energy. It centers on oil, reflecting that natural gas became an important part of the energy mix only more recently. The second part discusses three present aspects of cooperation and conflict: first, the new forms of cooperation among companies in the vertical markets structure; second, the role of international governmental organizations as instruments for political governance of the oil market; and third, a case of global cooperative behavior and regional conflictual behavior in the international gas markets. The chapter ends with a tentative attempt to look into the future of cooperative and conflictual energy relations. But first it is necessary to outline the perspective and key concepts guiding the discussion in this chapter.

Patterns of Conflict and Cooperation

Cooperation and conflicts in the oil industry appears in both the vertical and the horizontal market structure. The vertical structure is the stages of refinement of the product from raw materials to the final product sold to the end user. In the vertical structure
market power arises as actors are able to control other actors’ outlets or access to the goods traded at the various stages of the product chain. In the oil industry we usually call exploration and production of crude oil, the upstream segment of the market, and transportation, refining, marketing, and sales, the downstream segment. The horizontal structure is the relationship between companies in the various stages of the vertical structure. In the horizontal structure market power arises as actors are able to form monopolies, oligopolies, or various forms of cartelization of the market. The horizontal structure forms the basis for the exercise of market power by coherent action by a group of actors that might lead to the realization of monopoly profit. One fundamental feature of the oil industry is that the upstream segment, exploration and production of crude oil, can take place only where the oil resources are located. Access to these resources is a premise for any related commercial activity.

Oil, as with natural resources in general, has a surplus value after all costs and normal returns have been accounted for, called the resource rent. The potential for capturing this rent makes the control over the upstream segments particularly important and lucrative. Thus, the access to natural resources is usually controlled by governments as owners of the resources. A special relationship emerges between companies that have capital and technological know-how but seek opportunities for foreign direct investment in the upstream segment of the oil industry and host governments that control the ownership of oil resources but seek revenues from extraction of the resources. Initially the companies have the upper hand as they can choose where to go, but once they have made a substantial amount of investments they are hostages in the hands of the government. The companies’ investments are sunk costs and the government can impose additional conditions on the companies and increase taxation without risking the companies leaving the country. This phenomenon was named the obsolescing bargain by Raymond Vernon (1971: 46–59). The relative power of governments and companies in the oil industry and the value of the resource rent have varied over time. Thus, the relevance of the obsolescing bargain has also changed. Vivoda (2008) argues that its relevance has increased in recent decades.

Energy is an important input factor in most industries, a prerequisite for modern transportation and vital for almost all kinds of human activities and general welfare. This has motivated political interference in energy industries at the local, national, regional, and international levels. Prospects of shortages or shutdowns in the supply of oil have caused oil-consuming countries, in particular the US, to use foreign diplomacy, economic bargaining, and military force to regain security in oil supplies (Klare 2004: 26–74). Such cases of political interference gain high public attention. They also have implications for the analytical approach to the oil industry: “Oil, unlike other commodities, has a universality of significance which in the real world places limits on the application of economic rationale to the evolution of the industry” (Odell 1986: 38). Energy is a topic in need of “some analytical framework for relating the impact of states’ actions on the markets for various sources of energy, with the impact of these markets on the policies and actions, and indeed the economic development and national security of the states” (Strange 1988: 191).

The political importance of energy supplies means that the conflict and cooperation takes place (1) among countries, like the producer cooperation among OPEC countries and the consumer cooperation in the IEA; (2) among companies, like the historic case of the Seven Sisters and today’s various types of collaboration between companies both in the vertical and horizontal market structure; and (3) between governments and companies, like when the Church commission of the US Congress attacked the US oil companies for contributing to the oil price rise of the early 1970s. This pattern of relationship
illustrates what Stopford and Strange (1991: 1) called the *triangular diplomacy*. The fact that political actors are increasingly involved in business activities and the fact that the behavior of companies has political implications leads to a dynamic interaction between these three different relationships. In the age of globalization and after the 2008 financial crisis this is all too obvious. The international oil industry has, however, always had a prominent political importance. In fact, one could say that oil became a strategic commodity before it gained its present broad commercial importance. As part of the naval arms race with Germany prior to World War I the British First Lord of the Admiralty, Winston Churchill, took the decision to switch from coal to oil-fired naval vessels. This had two major implications: first, the oil market became an international market, as the oil used in these vessels was located in the Middle East; second, it became highly politicized because of the immediate security importance of the oil resources for warfare. The next section provides a brief account of the history of conflict and cooperation in the international oil market.

The History of Cooperation and Conflict in the International Oil Market

The strategic importance of access to the oil resources in the Middle East triggered a conflict among the victorious Allied Powers of World War I with direct implications for the private oil companies.

After the war Britain tried to make Mesopotamia a British mandate under the regulations of the League of Nations. One aim was to gain British control over oil resources in the region. However, according to the Anglo-French oil agreement signed in San Remo in April 1920, France got 25% of the oil from Mesopotamia. This upset the US government as it revoked the principle of the Paris peace negotiations that the war had been won by the Allied Powers fighting together and any economic benefits should be available to all Allied Powers (FRUS 1920: 649–659). The US also claimed that “the San Remo agreement discriminated against the rights of American nationals, that no rights in Iraq were vested in the Turkish Petroleum Co., and that no valid concessions could come into existence through the government of the people of the territory” (FTC 1952: 51–52). The British government argued that British nationals had “acquired rights.” The fact that the US had been an Allied Power gave it no right to trespass upon such rights.

After long negotiations, the US, Britain, and France reached a compromise in 1928. The American companies got one-fourth of the Iraq Petroleum Company (IPC, formerly the Turkish Petroleum Company) concession. The companies and authorities also agreed to the so-called self-denying clause of 1914 stating that all parties should work jointly – and only jointly – in the region (Yergin 1991: 204). The region included the Arabian Peninsula (except Kuwait), Iraq, and Turkey. This was the so-called Red Line Agreement (Yergin 1991: 203–206). In the areas inside the red line, the companies would pursue joint concessions. As soon as the US companies were included in the agreement, the open-door policy was abandoned and the door was shut to any new company (Anderson 1981: 19). Although the private international oil companies (IOCs) were important players, and to some extent pushed the governments into the Middle East, the governments of the US, Britain, and France took the leading role in defining the rules of the energy game in the area. Furthermore, the policy process was one of interstate bargaining. However, the companies where soon to gain full control over the international oil business through an elaborate but tacit form of cooperation.

By 1928 more than 50% of oil production outside the US was controlled by Exxon, Shell, and British Petroleum (BP). These companies took their cooperation one step
further when they met secretly and worked out a market-sharing deal, the so-called “Achnacarry Agreement,” also known as the “as-is” agreement (Yergin 1991: 260–265).

This was an agreement to keep the respective percentage market shares of sales in various markets and thus not challenge each other’s positions. Another important point in the agreement was the “Gulf plus pricing system,” according to which crude was to be priced as if produced in the Mexican Gulf regardless of actual origin. Later the companies also agreed to control production. In the following decades most of the other US companies joined the agreement. Various agreements covered operations in all countries except the US and the Soviet Union. By the end of the 1920s, the companies had set up agreements governing their interrelations in the whole production chain. After World War II the international oil market was totally dominated by seven companies, popularly known as the “Seven Sisters.”

They were integrated companies in the sense that they controlled the entire production chain from exploration to sale of the refined products. As of 1953 these companies controlled 95.8% of the reserves, 90.2% of the production, 75.6% of the refining capacity, and 74.3% of the product sales outside the US and the communist bloc (Schneider 1983: 40). This created a stable structure.

Only a few firms were capable of the risky search for oil in remote and often harsh places. In each consuming country, refining and marketing was a small industry, protected by distance and government. Production was too risky without an assured outlet, known as “finding a home for the crude.” Refining was too risky without an assured supply of crude. Hence in each country few sellers were confronted by few buyers, and neither side wished to be at the mercy of the other. The obvious solution was vertical integration (Adelman 1995: 44).

The integrated structure created high barriers to entry for other oil companies, also called the newcomers. The Sisters informally organized their operations in the Middle East through a consortium in which all the major companies were engaged in at least two countries (see Table 11.1).

In this way, the Sisters stood stronger against possible regulation by the producing countries, as none of them was totally dependent on the will of one government only. If the government of a producing country should put pressure on one of the Sisters in order to increase taxes or introduce less favorable conditions, this company could increase its operation in another country. The other Sisters would compensate the company that was under governmental pressure. This solidarity between the Sisters made it hard for governments of producing states to increase their control and revenues from oil production

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<tr>
<th>Company</th>
<th>Iran</th>
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<th>S. Arabia</th>
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<td>7</td>
<td>11.875</td>
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<td>Texaco</td>
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<tr>
<td>Mobil</td>
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<tr>
<td>Gulf</td>
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<td>BP</td>
<td>40</td>
<td>23.75</td>
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<td>Shell</td>
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<td>CFP</td>
<td>6</td>
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<td>Iricom</td>
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<td>Gulbenkian</td>
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within their own territories. The Sisters were able to recreate on the international scene some of the features of the logic behind the strategy of Standard Oil in the US market 70 years earlier, a position that had been broken by anti-trust legislation. The Sisters’ tacit cooperation in the Middle East would clearly have been illegal in the US (Odell 1986: 16). The position of the Sisters is an extreme case of how cooperation among multinational companies can define the rules of the game in a vital economic sector.

The Sisters’ control over the international oil market lasted until 1971. There is a widespread belief that the decisive change in the oil market appeared in 1973 when the Arab oil producers initiated an embargo to the US in order to make the US change its support for Israel in the ongoing Arab–Israeli War. This is a misconception. The decisive change took place two years earlier in 1971 with the Tehran and Tripoli agreements between the IOCs and members of OPEC. Now the control over the oil market changed from the IOCs to the producing countries. A key factor behind this change was the increased unity among the producing countries and the emergence of new IOCs, the “newcomers,” that did not adhere to the tacit agreement among the Sisters.

After the 1956 Suez crisis and the 1967 Arab–Israeli War, North African oil exploration intensified. North African production had an important advantage over that in the Persian Gulf in that the oil did not have to be transported through the conflict area around the Gulf and the Suez Canal. As Libyan oil contained less sulfur than most Gulf oil, it was cheaper to refine and could therefore be priced higher than the heavier crudes of the Gulf region. “Because of these advantages, Libya received the highest per barrel payments of any Arab government, but most observers still considered Libyan oil underpriced” (Schneider 1983: 140). Furthermore, Libya was not part of the Sisters’ cooperation. Other independent US and European oil companies had almost 52% of the Libyan oil production. This, together with a new radical regime, meant that the road was open for a confrontation with the oil companies. In September 1969 a coup d’etat took place in Libya and Muammar al-Qadhafi became leader. In January 1970 the new Libyan government started price negotiations with the companies individually, not as a bloc. By playing the independent Occidental and the other multinationals against each other, Libya managed to raise posted prices and the government take thereof.

After the Libyan affair, Iran and Venezuela increased their share of profits and a “game of leapfrog began” (Yergin 1991: 580). After some internal differences, the companies united in a common front and sought to negotiate with OPEC in two rounds of negotiations: one with the Gulf exporters and one with the Mediterranean exporters. It should be noted that the market structure had not changed; there was no scarcity caused by underlying changes in the relationship between supply and demand: “From early 1971 to nearly the end of 1972, prices increased despite continuing substantial excess supply” (Adelman 1995: 93).

In February 1971, the so-called Tehran agreement between the IOCs and the OPEC members exporting through the Persian Gulf was signed. In April a similar agreement was signed for the OPEC members exporting through the Mediterranean. The agreements covered tax and price increases, inflation compensation, and a fixing of such rates for future years. The effects of the agreements were a 21% price increase for Saudi Arabian crude (from $1.80 to $2.18) and an increase in revenue of 38.9%. What was more important, however, was the fact that the producer countries had now gained control over the price. By these agreements the distribution of market power in the international oil market changed dramatically.

The outcome of the Tehran and Tripoli negotiations was the result of a combination of lack of unity among the IOCs and a newfound unity among the OPEC members. One
could argue that both factors were necessary, but neither of them alone was sufficient to explain the events of 1971. A unified OPEC strategy would not have succeeded unless the unity among companies had begun to crack. The lack of unity among the companies would have meant nothing unless the OPEC members had gained some ability to act in concord.

After 1971 the role of the IOCs in governing the international oil market diminished. A new group of companies emerged: the national oil companies (NOCs). The NOCs were initially created as instruments of government policy, whose aim was primarily to assert sovereign rights over national resources. In a context of resource nationalism, they were to give the state control over the pace of exploitation and the pricing of its finite resources. NOCs also ensured that the state received an equitable share of profits (Marcel 2006: 8). By the mid-1970s, therefore, most of the OPEC members had de facto nationalized their oil industry. In the 1970s the NOCs could be regarded as only part of the public policy of the producer governments and not as actors with independent aims and interests.

In the 1980s and 1990s the international oil market changed character once again. In particular the price fall of 1986 changed the market. With oil prices in the range of $15–25/barrel no super profit was to be gained either by companies or countries. Oil was to a large extent a commodity like any other commodity. The price increases over the last decade have again raised the stakes in the oil market. Most producing countries and some newly important consuming countries (especially China) have vitalized the role of their NOCs. Some analysts draw pessimistic conclusions based on the renewed market power of the NOCs:

If an increasing proportion of global oil and gas resources are under the control of NOCs, it is reasonable to expect that an increasing majority of oil and gas developments will be driven with political objectives in mind. Relative to a commercial outcome, this will result in inefficiencies in the production of revenues, which can manifest through lower levels of production and higher prices than would otherwise occur. (Eller et al. 2007: 33–34)

However, along several dimensions the nature, behavior, and roles of NOCs are very different today from the situation in the 1970s. First, although the NOCs of the 1970s were almost totally oriented toward the domestic oil industry, several of today’s NOCs are going abroad. There they face other NOCs on the opposite side of the negotiation table. Marcel (2006: 218) finds that Middle East NOCs distrust other NOCs and do not find them attractive partners, as they complement their own strengths and assets to a lesser extent than IOCs. Nevertheless various alliances between NOCs are emerging, something that did not happen in the old structure. One illustration is how “Sonatrach, Statoil, Petrobras and Saudi Aramco are active participants and organizers of the NOC Forum, which … has brought CEOs of national oil companies [together] to share ideas on how to develop NOCs’ core competences” (Marcel 2006: 220). Second, the oil industry has become more fragmented during the last three decades, as oil companies have outsourced several engineering and technological services. Thus NOCs can acquire technology from other sources than the IOCs (UNCTAD 2007: 118). Third, various forms of contractual relations between oil-producing governments and IOCs have emerged (Likosky 2009). Consequently, the IOCs have re-entered exploration and production in many of the countries that they were kicked out of in the 1970s. Fourth, the wide varieties of alliances between NOCs and IOCs have become the order of the day. This will potentially influence the operations and behavior of NOCs in a commercial direction. Marcel (2006: 209) observes “an increased blurring of differences between NOCs and IOCs.”
Cooperation and Conflict in the Present Oil and Gas Markets

The blurring becomes even more prominent when we consider the vertical structure of the market. Here we find cooperation and conflict among companies acting as sellers and buyers in the various stages of the value chain of the oil industry.

Vertical Cooperation and Conflict Among Oil Companies

The OPEC countries dominated the upstream segment from the 1970s. However, the IOCs still controlled the downstream segment of the market, such as refineries, marketing, and product sales. From the early 1980s some of the major oil-exporting countries have made downstream investments in Western Europe and the US, gaining partial or total control over companies that can refine and distribute part of their crude oil exports in the main consuming countries, with the aim of securing outlets for sales and thereby more stable revenues in an increasingly volatile market. These exporters also bought tankers, harbor and storage facilities, and petrochemical plants in consuming countries. Among the largest downstream investors were Kuwait, Venezuela, Saudi Arabia, Libya, and Norway. By 1990 Kuwait and Venezuela had refining capacity (domestic and foreign) covering 90–100% of their production capacity; the corresponding figure for Saudi Arabia was about 50% (Finon 1991: 264).

In the upstream segment of the market there were similar problems. Between 1985 and 1987 the seven largest majors replaced only 40% of oil consumed in the US and 59% outside the US through new discoveries, extensions, and improved recovery rates in existing fields. When revisions of oil reserves and purchases are taken into account, the majors’ replacement was still 11% short compared with production. The majors – primarily Exxon, Shell, and BP – purchased reserves from smaller companies that were either cutting back their oil activity or dropping out of the industry completely, but the majors were still “crude short,” even if they were better off in this regard than some of their smaller competitors. The companies seemed to be preparing for a more competitive environment, in which increased size is perceived as necessary in order to take higher risks in upstream investments. For the OPEC countries the key problem was the ability, or rather lack of ability, to finance the necessary investments in their existing production facilities, on their own. As most OPEC countries produced close to capacity, increase in production capacity would imply new investments. The financial reserves of the OPEC countries were no longer what they were in the heyday of high oil prices. By 1990 virtually all OPEC countries were in need of more financing, more technology, and more organization (Finon 1991: 263). Many OPEC countries revised their policies and opened up for production-sharing agreements with foreign firms.

In the 1990s these developments created a new order based on a convergence of interests between the IOCs providing technology and financial resources for exploration and production and producing countries controlling the access to the resources. The large oil exporters searched for secure outlets for their crude oil in order to protect themselves against future market volatility. Downstream integration is an expression of a risk-averse attitude on their part, which is understandable given their experience in the oil market during the 1980s. Companies with financial difficulties need new investments, for example in their refineries, whereas crude-short companies are interested in arrangements improving their access to oil reserves. For the IOCs, joint ventures with NOCs from the OPEC countries provide protection against future scarcity, which was the companies’
nightmare of the 1970s. This opened the way for the companies’ return to the upstream market, and subsequently partly reversed the structural change of the 1970s.

**International Governmental Organizations: OPEC and IEA**

Cooperation among states depends in part on institutional arrangements. Any discussion of cooperation must take into account the role of institutions (Keohane 1989: 3). There are several ways in which international institutions can increase cooperation between states. First, institutions can provide the actors with necessary information about the other actors’ preferences. Second, institutions can provide negotiation frameworks that reduce transaction costs and thus increase the effectiveness of interstate transactions. Such frameworks can also help coordinate actors’ expectations by establishing conventions. Third, institutions can change the cost-benefit calculations of states, or the incompatibilities of their positions, by providing an arena for issue-linkages, mediating between states, and providing instruments for verification that actors are abiding with agreements or sanctions for those who are not. Fourth, institutions can “frame” how decision-makers view their collective options, as well as contribute to the creation of collective identities.

By far the most important intergovernmental cooperation in the oil market over the last 40 years has been the cooperation among the OPEC members. In the 1970s OPEC as an institution played a minor role, as the oil producers where able to increase the price of oil and increase sales volumes at the same time. As a producer you don’t need any common rules or regulations to do that. However, following the oil price rise after the Iranian revolution and the outbreak of the Iran–Iraq war, the demand was weakened. The price increases during the 1970s made possible increased energy efficiency among consumers and the development of new oil provinces, like the North Sea and Alaska. This development made it necessary for OPEC in 1982 to start behaving like an operative cartel, adjusting production levels in order to sustain prices. There were wide differences between the OPEC members over their willingness to adhere to the individual production quotas. In general, Saudi Arabia took on the role as swing producer, leaving room for the smaller members to exploit the big one. However, the weakening of the market continued even though Saudi Arabia had cut its production from 8.5 mbd in early 1982 to about 2.5 mbd in the summer of 1985. This caused Saudi Arabia to change its market strategy in 1985 in order to regain market share. Subsequently, the Saudi strategy became more of a coercive hegemonic power. By changing its strategy from trying to sustain prices by cutting production, Saudi Arabia tried to regain its market share by flooding the market with oil and thus instigated a price war with other producers. Toward the other OPEC members the aim was to force them to cooperate by cutting their production. Toward the new oil producers outside OPEC the aim was to force them out of business, in particular as they generally had higher production costs than the OPEC countries (Claes 2001: 281–297).

The consuming countries tried to counter the market power of OPEC by creating the International Energy Agency (IEA) in 1974. The core aim of the IEA was to handle future oil supply disruptions using an emergency oil crisis management system, originally triggered by a 7% reduction in daily oil supplies, but in 1979 a more flexible system of crisis cooperation was adopted, and this was used again in the Gulf War in 1991 and following Hurricane Katrina in 2005. The IEA has become a vital institution for providing information on international energy and its agenda-setting role has increased in recent years. However, as a market-governing institution it is safe to conclude that the IEA “has limited authority in rule creation and enforcement” (Kohl 2010: 198),
although the organization might contribute to coordinated consumer behavior by other means, such as information and statements regarding the market situation and proposals for joint action by the member states. The OPEC cartel had a similar market control to the Sisters, and the benefit of a dominant position in the upstream sector was transferred from the big private oil companies to the treasure chest of oil-producing countries.

Already in the late 1970s some initiatives were taken in order to create a dialogue between oil producers and consuming countries. In 1991 a gathering of ministers from both oil-producing and oil-consuming countries met in Paris. Such meetings have continued every two years and grown into a semi-formal organization called the International Energy Forum, which today has a permanent secretariat in Riyadh (Lesage et al. 2010: 61–63). On the political level it is fair to say that the cooperation among oil producers has been highly important over the last 40 years. The cooperation among oil consumers has been less important, but not totally unimportant. There has also been some attempt to establish cooperation between producing and consuming countries. These attempts have not yet had significant impact on the international oil market.

**Cooperation and Conflict in International Gas Trade**

Gas trade differs from oil trade in various ways. Most importantly in relation to the topic of this chapter is the fact that there is no genuine global gas market. There are three regional gas markets in the world, the North American, the European, and the Asian market. Thirty percent of world total gas consumption is traded across national borders. Almost 70% of this is traded through pipelines (see Table 11.2). Pipeline gas trade physically connects the seller and buyer, reducing the room for spot or short-term trade on competitive markets, unless the infrastructure is developed in order to facilitate gas-to-gas competition in various gas hubs. This is the case with the domestic US gas market, and is emerging in the European market (see below). Nevertheless, such gas-to-gas competition will be limited to the areas covered by the pipeline network.

The only way to create gas-to-gas competition between the three regional gas markets is by liquefied natural gas (LNG). Total global traded LNG constitutes less than 10% of world gas consumption and about 30% of total traded gas. Almost half of this LNG trade (46.34%) is Japanese and South Korean imports. Thus, LNG is not an important factor in most parts of the various gas markets. A substantially increased role for LNG is a prerequisite for the future evolution of a global gas market (de Jong et al. 2010: 221).

In 2001 some of the countries with large gas reserves created the Gas Exporting Countries Forum (GECF). The 11 member states account for 42% of gas production and 70% of world gas reserves. The Forum is not at all an operative cartel like OPEC, but signals awareness among gas producers of the potential for coordinated behavior in a situation where gas trade is globalized.

<table>
<thead>
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<th>Table 11.2 Gas consumption and trade, 2010.</th>
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<td><strong>BCM</strong></td>
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<td>Total consumption</td>
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<td>Total pipeline imports</td>
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<td>Total LNG imports</td>
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As indicated above there is no genuine global gas market that resembles the situation in the oil market. A number of factors influencing the future development of such a global gas market are presently changing. However, the different factors point in different directions. The reduced costs of LNG relative to pipelines increase the competitiveness of LNG in the established regional markets. On the other hand, the technological revolution making shale gas commercial, at least in the North American market, has made the US self-sufficient in gas supplies. This reduces the globalization of gas trade. Finally, the economic downturn in the US and Europe reduces prospects of a substantial increase in gas demand, moving the globalization of gas trade further into the future. If the aim is to create a global gas market, the main challenge seems to be how to increase the amount of traded LNG at the same time as making investments in LNG infrastructure (LNG tankers and export and import terminals) commercially viable. For such a development to create a genuine global market, different suppliers of LNG must meet competitive hubs in LNG-receiving terminals. Such a competitive marketplace would normally put pressure on prices, making LNG investments even more risky.

In the present situation it is hard to see a genuine global gas market emerging in the foreseeable future. Some LNG trade will take place between the three regional markets, but the volumes will most likely be insufficient to facilitate price harmonization and true interregional competitive behavior among consumers. The need for global producer cooperation is simply not here yet. Compared to the changing structure of the global oil market described above this suggest that in this respect the gas and oil market are becoming structurally even more different than they were before.

The most prominent displays of the cooperative and conflictual aspects of gas trade are found in the European market. There are of course important cooperative aspects in the energy policy of the EU. However, in this section I will confine the discussion to the conflict between the EU and its main gas supplier – Russia.

Russia exports about 50% of its gas to Europe, with currently no opportunity to diversify its gas export. EU countries, on the other hand, import about the same percent of their total gas consumption from Russia, thus making both parties dependent on each other. However, even though Russia is dependent on the income from gas exports to the European market, the European gas consumers seem relatively more dependent on Russian gas supplies, mainly because gas is an important commodity, which citizens rely upon in order to fulfill basic needs (heating, cooking, and so forth), and because gas in the short run is almost impossible to substitute, due to the fact that machinery operating on gas cannot use any other source of energy to function. A possible shut-down in gas supply from Russia to Europe will be extremely costly for the latter. When Russia temporarily suspended its flow of gas to Ukraine in January 2009, it became apparent how vulnerable certain European states are to disruption of their gas supply (see below). Structurally this relationship is highly asymmetric. In addition a shut-down in gas supply from Russia would hurt certain European countries harder than others, as the Russian share of gas imports varies across the European countries (Figure 11.1). This creates a competitive situation between the countries, and thus undermines the European Commission’s ambition to create a common approach to external energy relations. The individual trade structure increases the probability that some EU members that are dependent on imports of natural gas are vulnerable to political pressure from Russia. While some countries are worried about dependency on Russian gas, others are not. On the one hand, the Baltic States and Poland are extremely worried about the new Nord Stream pipeline going directly from Russia to Germany, as it could isolate them from western Europe. Their role as transit countries would disappear, which in turn
could leave them vulnerable to political coercion from Russia. Thus, the Russian threat of a shut-down in gas supply to eastern Europe could be a more realistic foreign policy instrument, as the new pipeline would ensure that western Europe would not be affected. On the other hand, Russia has no share of Belgian, Italian, and UK gas imports. In the case of France, imports from Russia constitute 23% of total gas imports, but only 3.6% of total energy consumption. These countries are thus not worried about importing gas from Russia.

The increase in Soviet gas export to Europe during the 1980s triggered high-level political concerns both in Europe and in Washington (Jentleson 1986). After the end of the Cold War such concerns eased, but the general goal of diversification of energy imports remains an important aim of all European governments. The eastern European countries are in a special situation since their infrastructure in electricity and gas was developed when they were part of the Soviet-dominated Comecon. The energy relationship among former allies became particularly conflictual between Russia and Ukraine. During the 2000s both the price of gas imports to Ukraine and the Ukrainian fee for transit of gas to the rest of Europe became highly disputed both on the company and political level. As most of Russian gas exports to Europe were then transferred in pipelines across Ukraine this conflict also infected the relationship between all European gas-consuming countries and Russia.

On January 1, 2009, Russian exports to Ukraine were halted completely. The gas intended for transfer to other European customers was maintained. However, the next day the pressure in the pipelines to Hungary, Romania, and Poland dropped. After two weeks the dispute was settled, but both the high level of dependency and the dubious reliability of Russian gas were fully demonstrated. Furthermore, the Europeans are worried that Russia can use their dependency on Russian gas for political purposes, and
interpreted the Russo-Ukrainian gas disputes as an example of such politicization of the European energy trade. Almost the opposite perspective can be applied to the understanding of the Russian policy. During the Cold War the Soviet Union used cheap energy supplies as a political instrument in order to maintain the political loyalty of the East European communist states. After the end of the Cold War Gazprom started behaving more commercially and demanded a market price for Ukrainian gas consumers, and also no longer accepted delayed payment. To put it bluntly: the more commercially Gazprom behaves toward Ukraine the more Russian behavior is interpreted as political.

The Future of Cooperation and Conflict in Global Energy Markets

In this chapter a long historical view has been applied. A hundred years have passed since Churchill initiated the politicization and internationalization of oil. For most of these years the oil business has been controlled by a small group of actors through close cooperation among themselves: first the victorious Allied Powers of World War I, next the Seven Sisters, then the member states of OPEC. Today, the set of influential actors in the oil industry has increased, and the structure has become more complex. It is unlikely that this “network” structure will imply a shutout of the traditional IOCs. However, their role is changing, and will continue to do so in partnerships with NOCs of both producing and consuming countries. In most cases producing governments are also likely to welcome the IOCs as partners in the development of their energy resources. After a period of transition such a structure could possibly be as stable as both the era of the Sisters and the OPEC era. But it will not give a single group of actors the kind of market power that characterized the previous periods. At face value this increased complexity implies weaker governance and increased instability, which potentially can result in increased conflict among both companies and countries. To avoid this “policy-makers need to adapt and strengthen the institutional architecture of international oil and gas relations” (Goldthau and Witte 2009: 390).

Since oil trade has become globalized and the interdependence among the actors has increased, political institutions should also be renewed. This can lead to a more cooperative climate. As pointed out by Goldthau and Witte (2010: 355) the “energy world of the future is unlikely to be a world of producers versus consumers, or old consumers versus new ones. The main reason for this is that all actors in the energy domain have shared interests.” They suggest the need to establish institutions for correcting market failures, for lowering transaction costs, and for setting standards and rules (Goldthau and Witte 2010: 344–350). To what extent commercial actors and policy-makers have a similar perspective on the energy future of the world remains to be seen.

It is unlikely that the role of hydrocarbons will be the same in 2112 as it is today. Most likely the next 100 years will include a global energy transformation. The transition can happen sooner if concerns regarding environmental degradation and climate change lead to implementation of energy policies in key countries (potentially globally) promoting renewable energy sources at the expense of hydrocarbons. The transition can happen later with increased recovery rates of existing oil and gas reserves, increased ability to make new discoveries in new territories, and development of new technology able to extract unconventional oil and gas resources. What is certain is that this transition will create conflicts among companies and countries and its success rests on the ability of all actors to find cooperative arrangements. Both in the case of climate change and the depletion of
hydrocarbon energy resources, the companies and countries all over the world are truly in the same boat.

Notes

1. This chapter has been written as part of the Geopolitics in the High North programme (www.geopoliticsnorth.org), funded by the Research Council of Norway.
2. The term “acquired rights” referred to the rights held by the Turkish Petroleum Company and the rights promised to that company by the Ottoman Grand Vizier, as evidenced by his letter of June 28, 1914, to the British and German ambassadors (FTC 1952: 51–52).
3. A draft version by BP is included in Bamberg (1994: 528–534). It is assumed to correspond to the final text.
4. The name “Seven Sisters” was phrased by Enrico Mattei, the director of ENI, the Italian national oil company, and later used by Anthony Sampson as the title of his book about the big oil companies (Sampson 1975), and includes Exxon, Texaco, SoCal, Mobil, Gulf, BP, and Shell.
5. In 1890 the US Congress passed the Sherman Antitrust Act with the aim of restricting monopolistic and anti-competitive market behavior of large corporations. In 1906 the US administration prosecuted Standard Oil for violation of the Sherman Act. In 1911 the US Supreme Court rejected the company’s final appeal and Standard Oil was broken up into 34 different companies (Yergin 1991: 106–110).

References


