

## **Tomorrow's Mores:**

*The future geopolitical system and the structure of the international oil market*<sup>1</sup>

Coby van der Linde, Wilbur Perlot, Femke Hoogeveen<sup>2</sup>

### **Abstract**

Projections of oil demand and supply in the coming decades imply that major consumer countries must increasingly compete for the same oil flows. The international political and economic framework governing this competition is unclear at the moment. The bipolar system of international relations of the 1970s has made way for the post-cold war uni-polar situation of the 1990s, in which the mores of the market oriented system was expected to become the global mores. Recently, trends that would take the international system in a different direction have come to the fore. For instance, the re-emergence of resource nationalism has brought competition for oil in the realm of politics rather than economics. Such a development impacts on the risk assessment and questions the *in situ* security of supply policies. What the exact rule-set of the geopolitical system of tomorrow will be is unclear. Security of oil supplies policies therefore need to be reviewed on robustness for different geopolitical futures and the new fundamentals of the oil market.

### **1. Introduction**

Oil is politics. Securing access to cheap oil is part of national economic and foreign policies. Although, the relative contribution of oil to economic growth has declined, the structural dependence on oil in some sectors, for instance the transportation sector, and the oil price-linkages to other sectors, for instance gas, can imply that the economic impact of scarcity and/or a disruption is still disproportionately large. Therefore, security of oil supply matters. Moreover, because of the international political and economic dimensions, security of energy supply policies increasingly fall within the realm of both energy and foreign policy.

After a period of low prices and relative abundance of oil in the 1990s, the market has become very tight due to increasing demand and low investment levels in the 1990s. Spare production capacity has reached a very low level indeed. The current, often, unrelated short disruptions of production in various producing countries and the growing demand in the dynamic Asian economies of India and China has created a tight market situation in which every uncertainty about supply, real or imagined, translates in higher prices. Furthermore, the change of the international oil market from a buyers into a sellers market has renewed the assertion of the producing countries that they should benefit from a fair distribution of economic rents. In the period 1985-1999, consumer countries had successfully captured those benefits. The debate about the rent distribution in the value chain includes a debate about the organisational structure of the oil sector in countries and investor access to reserves, and renewed fears of the use oil (and gas) in power politics.

Since 1989, the geopolitical system is changing. The past has shown that in the case of oil, the state of the world matters to the way in which energy diplomacy is accomplished.

---

<sup>1</sup> This article is based upon: Hoogeveen, F. and Perlot, W. (eds), *Tomorrow's Mores: The International System, Geopolitical Changes and Energy*, The Hague, December 2005; Van der Linde, C., Energy security in a changing world, In: Bracken, P, et al, *Managing Strategic Surprise; Lessons from Risk Management & Risk Assessment*, Eurasia Group, September 2005; and Van der Linde, C., Energy in a changing world, Inaugural address, December 2005, Clingendael Energy Papers no. 11, available at [www.clingendael.nl/ciep](http://www.clingendael.nl/ciep).

<sup>2</sup> Coby van der Linde is director of the Clingendael International Energy Programme and Professor of Geopolitics and Energy Management at Groningen University. Wilbur Perlot and Femke Hoogeveen are researchers at the Clingendael International Energy Programme.

Oil policies and energy relations will shape along the lines of the future international system.<sup>3</sup>

This article will argue that the changing nature, intensity and rules of competition for oil require an re-examination of the effectiveness of some security of energy supply policy instruments. Section 2, presents an overview of security of oil supply policies in relation to the oil market developments and the geopolitical system of the 1970s. At the end of the Cold War in 1989, this previous bipolar geopolitical system was seemingly replaced by a unipolar system (section 3). Starting around 2002, the oil market rapidly turned from a buyers' market into a sellers' market. At the same time the changes in the geopolitical system became apparent (section 4). How effective can we expect the traditional security of oil supply policies to be in the new market conditions? This depends for a large part on the mores determining future geopolitical and economic relations. We distinguish three possible futures (section 5) before coming to the concluding remarks (section 6).

## 2. Oil revisited

The oil market of the early 1970s easily compares with today's to the extent that also then strong oil demand growth and discussions over the distribution of economic rents were important matters. From this decade stem two fears which still drive current energy security policy. The first is the fear that energy (oil, natural gas) will be willfully used as a political weapon, or at least as a means to gain political leverage. The source of this fear lies in the events surrounding the 1973 oil crisis (oil embargo). The second is the fear originating in the 1979 oil crisis that political instability in producer countries (in this case the Iranian Islamic revolution) and regional tensions will lead to a reduction or disruption of oil supplies (Iran-Iraq war in the 1980s, the first Gulf war and the gas conflict between the Ukraine and Russia in 2006).<sup>4</sup>

Today these fears feature prominently in policy documents throughout the world, including the new Green Paper of the European Commission. This paper states: "Our import dependency is rising. Unless we can make domestic energy more competitive, in the next 20 to 30 years around 70% of the Union's energy requirements, compared to 50% today, will be met by imported products – some from regions threatened by insecurity."<sup>5</sup>

The turbulent 1970s led to the formulation of a set of successful security of supply policies:

- Diversification of supply, predominantly away from OPEC and Middle East producers;
- Maximising indigenous production, for example in the North Sea and Alaska;
- A crisis regime to deal with supply disruptions, the IEP within the International Energy Agency (IEA);
- Diversification to source to change the fuel mix, for example nuclear and coal power stations instead of oil fired power plants;
- More efficient use of energy;

---

<sup>3</sup> Correljé, A. and Van der Linde, C., Energy supply security and geopolitics: A European perspective, In: *Energy Policy*, 34 (2006), p. 533.

<sup>4</sup> In 1979 the Iranian revolution caused a disruption of roughly 4-5% of total global supplies. However, the combination of expected future oil demand growth, instability in the oil industry, contradicting and conflicting policies by consuming countries, policies by producing countries to profit from higher prices and the effect of the emotion of uncertainty, made it possible that this disruption of 4-5% translated into a price increase of 260%. Yergin, D., *The Prize; The Epic Quest for Oil, Money and Power*, 1991, Free Press, New York, pp. 684-6.

<sup>5</sup> European Commission, *A European strategy for Sustainable, Competitive and Secure Energy*, COM 2006, p. 3.

- Incorporating energy in foreign and security policy, for example by building good and strong relations with producer countries.

In the wake of the 1973 crisis, the US feared that the EU member states' import dependence made them too vulnerable to withstand Arab political pressure, thwarting other political and strategic interests. To counter this, the US was a strong advocate to form a common front to OPEC. The International Energy Agency (IEA) was established in 1974 and the signatories agreed, among other things, on a common crisis policy.<sup>6</sup> The signatories were all members of the US-led 'market-oriented' group of (Western) countries that had participated in the Bretton Woods system and the more informal monetary system after 1973. Cooperation within IEA took place within the group of market oriented industrialized countries. The IEA member states successfully switched to other non-OPEC suppliers in the 1980s when these resources could be developed under the new post-1973 OPEC price regime.

The impact of the 1973/74 oil crisis on the group of centrally planned economies (Soviet Union and East Europe) united in the Comecon was not immediate but rather, came with a delay. Although the Comecon countries were self-sufficient in oil, their oil prices were calculated on the basis of average world market prices; initially based on a five year moving average and after 1973 on a one year average. The oil price increase made exports to the world market very attractive compared to inter-Comecon trade, except in the period 1985-1987 when world market prices declined and Comecon prices lagged. As a result, the share of the Soviet- Union and later Russia in EU-15 crude oil supply, for instance, increased from 5,2 percent in 1978 to 15,9 percent in 1988 and 28 percent in 2004. The ultimate impact of the 1973/74 oil crisis on the Comecon countries was that the autarkic energy system became more integrated in the world market.

The impact of the diversification of supply policies is evidenced by the declining share of North African and Middle East countries in, for instance the oil supply of EU-15, which declined from almost 70 percent in 1978 to 32 percent in 1985, increased to 45 percent in 1991, and declined again to 31 percent in 2004. The share of North African and Middle East countries in US crude oil supply declined from 26 percent in 1978 to 17 percent in 2004 (and was only 3 percent in 1985). The ability of Japan and South Korea to economically switch suppliers was more limited. The share of the Middle East and North Africa in the supply of Japan and South Korea was 67 percent in 1978, declining to 50 percent in 1988 and rising again to 79 percent in 2004.<sup>7</sup>

The success of developing indigenous resources is clear from the rapid advance of the North-Sea oil production and the share of the North Sea producing countries in the 2004 EU top ten of crude oil suppliers, with Norway at number 2 (not in the top ten in 1978), the UK at number 4 (up from number 5 in 1978), and Denmark at number 8 (not in the top ten in 1978).<sup>8</sup> However, the maturity of the North Sea oil production now implies a rapid decline of diversification possibilities in the near future. The success of diversification to source and energy saving policies can be illustrated by the fact that the European Union consumed less oil in 2004 than in 1978, 12,94 mbd compared to 13,83 mbd respectively.

In the longer term, the use of the oil weapon in 1973/74 had fairly disastrous consequences for the OPEC countries, releasing oil to the world market from various sources. The diversification to supply and source policies of consumer countries had not

---

<sup>6</sup> The IEP Agreement was originally signed by 16 countries: Austria, Belgium, Canada, Denmark, Germany, Ireland, Italy, Japan, Luxembourg, The Netherlands, Spain, Sweden, Switzerland, Turkey, the UK and the US followed by Australia (1979), Czech Republic (2001), Finland (1992), France (1992), Greece (1977), Hungary (1997), Korea (2001), New Zealand (1977) and Portugal (1981). Poland and Slovakia are candidate member countries. The IEA has a special agreement with Norway.

<sup>7</sup> All data taken from IEA Oil Information 2004, OECD/ IEA.

<sup>8</sup> Ibid.

only reduced demand for oil, but in particular for their oil. Around 1985, the sellers' market had turned into a buyers' market and the cost of stabilizing the market fell to OPEC. As a result, OPEC countries became more sensitive to security of demand and policies that would provide fair distribution of rents in the value chain. In discussions with consumer countries, like in the International Energy Forum but also in climate change discussions, OPEC countries began to stress security of demand as a way to secure oil income.

### **3. Post Cold War logic**

The geopolitical landscape changed considerably after 1989. The collapse of the Soviet Union persuaded Europe and the US that many countries would now fully integrate into the international market economy. The rule-set, or mores, of the market-based system would become the encompassing and dominant organising principle of the international political and economic system. To function properly in this system, countries had to embark on a process of full economic, legal social and political integration. In some consuming developing countries this reform process had been set in motion by the restructuring of their debts in the 1980s. Liberalisation of the balance of trade and later the capital account was actively promoted by the Bretton Woods institutions, the IMF and World Bank. This process of integrating developing countries into the world market system was expected to continue.

The transition process of centrally planned economies, such as in Russia and China, shared many features with the reform recipe that had been implemented in developing countries in the decade before. They were expected to integrate gradually into the world market system (liberalizing their balance of trade) by negotiating WTO participation and in the case of Russia, also IMF governance to restructure debts. Moreover, in Russia, *Glasnost* and *Perestroika* were used as stepping stones towards the democratisation of party and state institutions. After the break up of the Soviet Union, the economic and political reforms would lead to a so-called mixed economy. China was expected to eventually become part of the market system and largely adopt the full rule set as well.

From the beginning, Russia was pressured more to adapt than China, partly because the political map of Europe was redrawn by starting EU accession negotiations with the East European and Baltic countries. The EU initiative to form a European energy space in the late 1980s, in response to Gorbachev's idea of creating a "European House", and which later became a more politically watered down version in the European Energy Charter, further evidenced the attempts of the EU to formulate its own foreign policy towards the Soviet Union and its subsequent attempts to integrate Russia in its own rule set. Throughout the 1990s, the EU continued to convince Russia of the benefits of its market design for the energy industry to Russia. Russian adoption of this design would have been a major step towards full Russian acceptance of the European (regional) rule set. Moreover, it would have removed the political and economic obstacles for possible deeper integration of Russia into the EU economic sphere in the longer term. The approach of Russia was also self serving because it was assumed that the internal EU gas market could only be achieved when key suppliers such as Russia, but also Algeria, accepted the market logic of the EU. The political and economic weakness of Russia in the 1990s was exploited to attempt exporting the EU rule set eastwards and leverage the power of the EU in the Russian sphere of influence in the region.

In the 1990s, the energy-rich countries around the Caspian Sea were expected to develop their economies, especially their energy sectors with foreign direct investment. No longer a bloc or under tight Soviet control, they would provide the new and diversified energy flows for the international oil market, in fact replacing the North Sea as a fringe competitor to OPEC. For this to materialise, it was important that the Caspian Sea oil and gas reserves could be developed beyond the reach of Russia and Iran and by international oil companies. These companies had been instrumental in developing the new oil provinces in the 1970s and 1980s, which contributed to the diversification of

supply of IEA member states. The Baku-Tblisi-Ceyhan (BTC) pipeline was a confirmation of this strategy. The attempts to establish the market rule set in the Caspian Sea region was much more of a joint effort with the United States than the direct efforts to integrate Russia into the EU rule set.

The low oil prices of the 1990s and the accompanying economic hardship in producing countries, convinced the industrialised countries that OPEC countries would also require foreign direct investments for the development of the next generation of oil production capacity. However, this would imply deeper integration into the market-based system. The ruling elites in the countries around the Persian Gulf were reluctant to accept the implications of such a step to their power base and, instead, tried to win time by applying OPEC production policies. The Iranian ruling (religious) elite feared losing its grip on society, and as a result the risk of defeat of the Islamic Revolution. In Saudi Arabia, reformers within the royal family met with resistance from their conservative relatives to push for a reform agenda. Iraq under Saddam Hussein isolated itself further. Only Kuwait and the United Arab Emirates made some progress in developing towards a more open society. Venezuela initially was moving in a similar direction. The Venezuelan state company PDVSA transformed from a traditional national oil company to a modern led company with comprehensive international investments strategies, efficiency schemes and with an increasing independence from government objectives. Internal resistance stopped the liberalisation of the economy in the late 1990s.

Relatively low oil prices in the period from 1986 to 1999 in combination with the concept of a better functioning open international oil market, made oil security as a strategic political objective more or less irrelevant. With the exception of the first Gulf War in which Iraq occupied Kuwait, oil could be secured in the market, while the OPEC spare capacity (located mainly in Saudi Arabia, Kuwait and the United Arab Emirates) was kept on stand-by to offset disruptions. In retrospect, the liberation of Kuwait by the large US-led coalition which ensured that the Persian Gulf oil reserves would not be dominated by Saddam Hussein, probably stimulated the euphoria about the new post Cold War world order. The decision by OPEC countries to employ their spare capacity to compensate for lost Iraqi and Kuwaiti supplies in the early 1990s, again demonstrated the commitment of these countries to ensure market stability. This commitment reduced the necessity for oil security strategies.

Globalisation, under which name the process of deeper integration into the market system was known, represented an economic model of the world, while the political, legal and social implications were implied parts of this integration process that would come with time. Globalisation was expected to become the major driving force in international political and economic relations and was a common goal that bound the US, EU and other OECD countries in their quest to promote the market system as the preferred model for the world.

#### **4. Dazzled hopes at the turn of the century**

Looking back, we must conclude that the expectation of the early 1990s about the oncoming globalised world has not (yet) materialised. Many trends may even point to the opposite, and some will argue that pursuing national state interests is again prevailing over economic internationalisation. Particularly, "resource nationalism" on both the demand and the supply side of the oil market is again on the rise.<sup>9</sup>

A key factor in the 1990s expectations for the future system was a well functioning, transparent, free and open oil market, where, so to speak, oil was washed from its nationality. If the market functioned properly, no additional safety measures would be really necessary. Economic reasoning and logic would prevail, leaving no room for politically motivated manoeuvring in the market, requiring only a safety net to absorb

---

<sup>9</sup> "Global or national?", *The Economist*, April 30, 2005.

short disruptions of both a technical or political kind. Due to bounded rationality governments tends to limits their wealth maximising behaviour because the fear factor would stimulate them to overshoot in security of supply measures.<sup>10</sup> Another factor is the tradition of certain countries to rely on their own policies and strategic insights and, consequently, they show a great reluctance to accept that some invisible hand will provide security of supply and that at no time power politics will interfere.<sup>11</sup>

Perhaps totally relying on the world market was a leap too far for the newest emerging economies in Asia, that came from a different governance tradition. There is also the fact that their companies were predominantly national companies that still had to conquer a place among the group of large international oil companies in the search for foreign oil projects. Subsequently, China and India adopted an equity and bilateral approach to energy supply security. Their (partially) state owned companies acquired concessions with the express purpose of supplying their domestic markets. Bilateral government-to-government agreements supplement these strategies that brought more government influence to the world oil market. Increased state influence can also be found at the supplier's side in Bolivia, Venezuela and Russia, in addition to producing countries, predominantly OPEC countries but also Mexico, where the state already holds a majority share in the sector. Recently, national sentiments have also encroached on the EU debate when cross-border takeovers of energy companies prompted the French and Spanish government to intervene in favour of the creation of a national champion. Tendencies of government to maintain tight control over the energy industry are getting stronger. The justification for these national approaches are diverse, but all can be summarized by security of demand and supply. The confidence that international markets will provide these securities has waned substantially in the aftermath of 9/11 when the US began to more actively enforce the full rule set of globalization as one of the strategies to combat terrorism.

The asymmetric dependency on imports from the Persian Gulf among the major consumer countries, such as Europe, Asia and the US, created a fundamental difference in the risk assessment of the region and how best to approach the region in terms of the available risk management instruments. With about 65% of world proven oil reserves in five Gulf countries, it was obvious that the region would play an important role in supplying the international oil market in the future. Particularly, Asian countries already are very dependent on Gulf supplies. The 2003 US intervention in Iraq was cause for alarm because the impact on other Gulf supplies was unknown. Since then, oil prices have increased substantially, partly because demand increased faster than supply and further reduced the level of spare capacity in the market, and partly because the risk premium on oil increased. The continuing unrest in Iraq has, for the moment, dashed the hopes of Iraq becoming a substantial producer in the near future. The US has raised doubts about its capability as the hegemon of the international market system to provide security of supply, and reinforced the idea that countries should pursue their own security of supply policies.

Since the beginning of this century, resource nationalism is on the increase in both producing and consuming countries. In the market for oil concessions it is often the best political price/quality offer that wins the day. With the US often seen as a antagonist of the autocratic regimes in oil producing countries, other countries, such as China and India, provide these regimes with an alternative approach to the international market system. China and India participate in the international system on their own terms and

---

<sup>10</sup> See for a definition of "bounded rationality" Van der Linde, C., Energy in a changing world, In: P. Bracken, I. Bremmer and D. Gordon, *Managing Strategic Surprise; Lessons from Risk Management and Risk Assessment*, Eurasia Group, 2005, pp. 244.

<sup>11</sup> See Hoogeveen, F. and Perlot, W. (eds.), *Tomorrow's Mores: The International System, Geopolitical Changes and Energy*, CIEP Energy Study, 2005, pp. 17.

do not (yet) challenge the political and economic system of producer countries.<sup>12</sup> Rather than follow the rule set of globalization they have redefined that rule set to suit their own national political and economic agenda. This approach was named 'weak globalization'.<sup>13</sup> The economic success of these predominantly autocratic regimes has created a following among elites in various countries because they fear the uncertain future under liberalized political and economic systems that the hegemon was promoting. This has become more prominent after the US began to more narrowly interpret the rule set to fit its own security agenda. The space for alternative approaches to globalization, which surfaced in countries, such as for instance China, Russia, Iran and India, was reduced.

The present international system is then still characterised by a struggle between two systems of thought and the values and strategies connected to each. It would be wrong to suggest that these two systems take the form of two opposing camps striving for global dominance, as was the case during the Cold War. The countries with an orientation towards 'weak' globalisation are not organised, so far they only share an orientation to mix national interests with economics. Contrary to the 1970s, the group of consumer countries is less coherent and do not have a common strategy. Important consumer countries with a market approach and consumer countries with a state oriented approach find themselves in direct competition with one another for oil reserves. In a period of amply supplied markets and investment opportunities this would not pose much of a problem, but in today's tight markets and limited investment opportunities, state supported companies that compete with 'Wall street' listed international oil companies has skewed competition to some detriment of these large private companies. The latter require higher rates of return than political deals can provide. If the Chinese and Indian markets were not growing so fast, the ability to convince producer countries for their approach would probably be smaller. Gaining market share for their oil in these markets has given the state companies from these consumer countries an additional benefit over the international oil companies, that have yet to get full access these markets. Since the governments prefer their own companies to operate on their markets, the internationals are increasingly facing a grim oil future; no access to easy conventional oil reserves and limited access to fast growing markets. The shift in core business for internationals to frontier and unconventional oils and gas has already materialised. With this development in mind, the smaller market oriented consumer countries, such as the European and some Asian countries, must look at these developments with some trepidation when the internationals alone can no longer guarantee the flow of reasonably priced and secure oil.

Fundamental shifts in demand and supply patterns and the organisation of supply and demand flows, challenge the existing security of energy supply policies of consumer countries. The geographical shift in oil trade patterns and in energy consumption has been substantial. In fact, Asia consumed more oil last year than North-America. As a result, Persian Gulf oil is increasingly traded with Asia rather than with the US and Europe. China has become the second largest oil market with a consumption of almost 6.6 mbd in 2004 of which 3 mbd were imported. China, Japan and South-Korea combined consumed only 400.000 barrels less oil than the EU in 2004, while the EU market will only increase by 0.3 percent annually until 2030. Chinese oil demand is expected to grow by 2,9 percent per year reaching 13,1 mbd by 2030. The oil consumption of India will increase from 2.5 mbd to 5.2 mbd in the same timeframe. Total global oil demand will increase from 79,2 mbd in 2003 to 115,4 mbd in 2030, while total energy demand will increase from 215 million barrels of oil equivalent (boe) per day in 2003 to 327 mboe per day in 2030. The share of oil declines slightly with 1 percent.<sup>14</sup>

---

<sup>12</sup> Van der Linde, C., *Energie in een Veranderende Wereld (Energy in a Changing World)*, Inaugural Lecture, Groningen University, 22 November 2005, <http://www.clingendael.nl/ciep>.

<sup>13</sup> Ibid.

<sup>14</sup> IEA, *World Energy Outlook 2005: Middle East and North Africa Insights*, Paris, 2005, p. 82.

At the same time, production is becoming more concentrated in but a few producing countries/regions because oil production in non-OPEC countries is maturing. In the period 1980-1999, countries such as Norway, the US, Mexico and Russia were in the Top 10 of largest oil producers. However, the bulk of the proven conventional reserves is located in five countries around the Persian Gulf: Saudi Arabia, the United Arab Emirates, Kuwait, Iraq and Iran. Their share in production has been low (30 percent) in comparison to their share in oil reserves (65 percent). Although some regions are still relatively underdeveloped, most notably West Africa and the Caspian Basin, all projections of future production show an increasing share for Persian Gulf oil.<sup>15</sup>

In the 1990s, European demand shifted away from Persian Gulf oil supplies towards Russian supplies. However, in the current European debate, after the Russian-Ukrainian gas conflict, the relatively high dependency on Russian oil and gas supplies is considered unwanted. The oil import dependency of the European Union is projected to increase to about 80% in 2030, while the dependency on gas imports will increase to about 70%. Diversification away from Russian oil imports will imply increased imports from other sources, where either China (Caspian Sea region and Persian Gulf) or the US is a competitor for the same sources (West-Africa).

### **5. A new context for energy security policies?**

The emergence of a tight oil (and gas) market, the geographic shifts in the flows of oil, changes in the relative distribution of processing capacities and security concerns throughout the oil value chain, have led to reviews of energy security policies and the optimal development of the energy mix in many countries.

Diversification to supply is, as a short to medium term solution, actively promoted by most consumer governments. Yet, with the changing supply pattern in the world and the concentration of net-exporting countries, this policy has a limited scope. Due to the dependence of the transport sector on oil, diversification to source and the reduction of the share of oil in the energy mix, offer limited possibilities.<sup>16</sup> However, stressing fuel efficiency and introducing for instance new generation biofuels in the transportation fuel mix could help manage demand growth. For other sectors, other fuel options are possible, but options such as coal are limited by the restrictions imposed by environmental policies. In the power sector, imported gas could be replaced, if economical, by renewable energy sources, coal and nuclear power plants. These options however each come with their own problems and costs.

“It is better to reduce than to produce” is an often heard statement regarding the management of unrestrained energy demand growth. The more efficient use of energy indeed still offers great possibilities as an integral part of any energy security policy in the new market circumstances. Energy saving and active switching-away-from-oil policies have a problematic side effect in that it might shy producer countries away from making the necessary capacity expansion in the face of demand uncertainty. Underinvestment and/or striking bilateral agreements provide the producers with more demand certainty than the competitive international market where consumer governments help promote alternative fuels. The EU has ratified the Kyoto Protocol and is preparing a post 2012 strategy, which will imply large reductions of green house gasses.<sup>17</sup> The main competitors of the EU for fossil fuels, the US, China and India, either

---

<sup>15</sup> See also Amineh, M.P., *Caspian Energy: A viable alternative to the Persian Gulf?* EIAS-Briefing Papers 03/02, Brussels, 2003.

<sup>16</sup> For an elaborate, though not complete overview of the different energy sources, its potential and impediments see chapter 3 and the Annex of F. Hoogeveen and W. Perlot, *Tomorrow's Mores: The International System. Geopolitical Changes and Energy*, CIEP Energy Study, 2005.

<sup>17</sup> See also Van der Linden, N., Van der Linde, C. and Hoogeveen, F., *The impact of the Kyoto protocol on the export revenues of OPEC member states; an update in the light of recent developments*, ECN/ CIEP, Petten/ The Hague, 2004 and Perlot, W., *Post-Kyoto and the position of the EU*, CIEP Briefing Paper Number 2, 2005.



did not ratify the Protocol or do not have any obligations to reduce emissions. Yet, also the US is actively seeking to reduce its import dependency.

The stated goal to reduce Middle Eastern oil imports with 75 percent voiced by president Bush in the State of the Union in 2006, could be seen as a veiled threat to these countries to reform or face a structural demand reduction.<sup>18</sup> How such a threat should be made credible in a market based system is another matter. Although, the US has used import quota before (introduced in 1958) to protect their domestic industry, the price to consumers and the competitive position of the country's industry could be too high to follow through on this goal. With the US and EU bend on an reduction of oil dependency policy, the competitors in the emerging economies of India and China will find that oil will come cheaper as a result.<sup>19</sup> Such sabre rattling might not impress the producer countries as much as the long term threat that investment in renewable energies poses to their one product economies. Announcements such as the one President Bush made, are prove of the growing uncertainty in the future of the international oil markets and about the development of their relations with the large oil producing countries in the Persian Gulf and elsewhere. The special relation between the US-Saudi Arabia has for many years provided security and stability in the oil market.<sup>20</sup> However, 9/11 and the subsequent "War on Terror" has greatly strained the special relationship, changing the power balance in the international oil market. Instead, China's president Hu Jintao is now a frequent visitor in Riyad. China is also active in giving support to security issues in the Caspian Basin.<sup>21</sup>

The past tool set for security of supply is becoming less effective in a market with new fundamentals. But the division in two systems and the likelihood one of these becomes more dominant than the other really determines the lines oil relations will develop. In a market based future, ensuring well functioning markets provide the best security of supply in which the liberalised EU market is a good strategy forward, while in a future with more national political international system strong bilateral ties with producing countries become more important and in which the Chinese link with Saudi Arabia becomes much more significant. Based on the current different orientations and possible rule-setters, it is possible to sketch three futures of the geopolitical system<sup>22</sup>:

- I. Expanded Functioning Core: this is basically the expected globalisation process of the 1990s with the US as the rule-setter, supported by the EU and Japan. For this future to come about, the US has to convince China that its interests are best served by the market-based system and that access to resources is best guaranteed by this system, while China at the same time has to prove that it is committed to a peaceful rise by offering transparency to Western countries. Security of supply is achieved mostly through the market. Security threats to oil infrastructure and instability in producing countries are dealt with in a multilateral setting. China, India and other upcoming countries will participate more and more in the IEA framework. Organisations such as OPEC and the IEA will predominantly operate as information nodes to their member states to facilitate the operation of the market and to assess future demand and supply. It is possible that both organisations cooperate to maintain strategic reserves and some spare capacities to compensate for market disruptions. Other consuming countries will join the IEA and producing countries might join OPEC when this no longer implies a political choice.

---

<sup>18</sup> *State of the Union Address by the President*, January 31 2006, <http://www.whitehouse.gov/stateoftheunion/2006/index.html>.

<sup>19</sup> Van der Linde, C., Energy security in a changing world, In: Bracken, P, et al, *Managing Strategic Surprise; Lessons from Risk Management & Risk Assessment*, Eurasia Group, September 2005.

<sup>20</sup> CIEP, *Study on Energy Supply Security and Geopolitics*, The Hague, 2004, pp. 69-70.

<sup>21</sup> Klare, M., *Blood and Oil: How America's thirst for petrol is killing us*, Hamish Hamilton, 2004, pp. 169-173.

<sup>22</sup> F. Hoogeveen and W. Perlot, *Tomorrow's Mores: The International System. Geopolitical Changes and Energy*, CIEP Energy Study, 2005.

- II. **Expanded Splendid Isolation:** this is an extended version of the weak globalisation trend. China is the perceived rule-setter in this future. China is not convinced of the market-based system and does not offer transparency on for example their military build-up. Hard line politics in both the US and China fuel mistrust and both focus increasingly on national interests rather than the interest of the international system. The rivalry between the US and China will grow and creates sufficient incentive for more strategic functioning by all actors, including Russia, the EU (or its member states), India and Japan. Each major actor tries to expand its political clout and attempt to bind oil-exporting countries to its sphere of influence. Military and political power will become more important. Security of supply is mostly arranged by direct bilateral dealings. The remaining oil is sold at premium prices on a sellers' market. In this future producer countries have ample political room to manoeuvre and they will try to make the most of this new position. The national interests of the major powers imply that they are directly involved in producer countries, keeping regimes in power, ignoring for example human rights issues. The fate of the IEA in this future depends on the level of cooperation within the group of current member states. It is possible that the IEA breaks up in regional parts. OPEC could continue to play an important balancing role in the international oil markets, but cooperation could be hampered due to different political alliances.
- III. **No Core, No Gap:** In this future neither the US nor China will be dominant enough to convince the other to follow in a certain direction. Instead of complementing each other, they rather mirror each others political actions. The US will continue to 'preach' the message of freedom, democracy and markets and China will present itself as an alternative to the American dominance while putting more emphasis on cultural and ideological differences. For many producing countries and semi-autocratic regimes such an alternative will be most welcome. It would for example greatly enhance the potential of the Bolivarian revolution of president Chávez in Latin America. The rivalry between China and the US may become one between systems forcing the other actors to choose between them. Oil security will take a hybrid form with market forces determining security in one system and direct bilateral dealings in the other. It is possible that IEA will be transformed into an organisation where the market economies pool, not only their oil policies, but also other energy security policies. Moreover, the IEA could help reduce import dependencies by becoming the organisation in which sustainable energy policies and strategies are initiated and supported. OPEC countries will provide both systems with oil, but some member states are tempted to cooperate more closely with allied consumer countries thus reducing the coherence of the organisations policies.

## **6. Concluding remarks**

Oil security has made a come back on political and strategic agendas. The oil market has shifted from a buyers' market to a sellers' market. Effective security of supply policies must be reviewed against these new market and geopolitical system conditions.

Since the beginning of the new millennium a new trend is visible in which national interests and political manoeuvring, especially in the oil (and gas) sector, are important elements in the political behaviour of China, Russia, and also the US. Whether this is just a temporary slow-down of the globalisation trend or a new dominant organising principle for the international political and economic system remains to be seen. This article offers no conclusion in terms of the most likely outcome, but it does point out that betting on only one future might, in the case of the EU, be risky if the strength to promote or influence the outcome of a certain rule set is weak. Many OECD consuming countries, including the EU member states, are ill-prepared to compete for oil in a setting in which

oil flows are for an important part determined by political leverage. For these countries, which rely heavily on the international market to deliver security of supply, a thorough evaluation of their energy policy options might be in order.