

# Policy Brief

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## Energy Cooperation : a Prerequisite for Sustaining Energy Security

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### Summary

Emerging economies started playing a more predominant role in the international agenda. Finance and defence, which were the major determinants of the global chessboard until the end of the Cold War, though still relevant, should give room to other essential elements to secure growth and prosperity. Energy security is of quintessential importance in this new world order.

The world has changed tremendously over the last seven decades. The end of the World War II led to the establishment of an international system based on containment and the imminence of a nuclear war that could wipe out humanity from Earth's face.

Financial institutions and defence mechanisms were created to address the challenges of a world widely threatened by the fear of another war. A whole international framework was established rewarding those nations that had won the war and the world order was organised in a way that reflected those values and players.

That world order, built upon the rock of the Cold War, remained effective and unchallenged until 1989, when the Berlin Wall fell and when Communism collapsed. New countries were added to the international system, which had to adapt to ease their transition. This stood in particular for the former Communist countries that needed to adapt to the challenges imposed by market economics.

Such transition has been particularly difficult for Eastern European countries. The ascension of China as a global player took over the resources that would otherwise be destined for such countries. The Chinese ascension – certainly the most relevant event of the early 21st Century – has been an essential element in the changes of the

world order, with a steady impact on the world economic output and the increase in international trade.

### The International Relations Debate on Energy Security

Since the Cold War, theories of International Relations (IR) have sought to identify key aspects of interactions between States, set up models to depict their nature and structure and set up a dimension of what the world should look like, if applied. A variety of theories, from Cold War realism to post-structuralism, has offered different theoretical and methodological approaches to address international subjects. An over-emphasis on the military dimensions of power has not ascribed to energy the relevant role it plays in securing economic growth, which is essential for the sustainability of military power itself. Since economic decline has a direct impact on military power, such hard power should not be the main factor for a country to become a global power, but a small part of the solution to current global threats, like drug trafficking, terrorism and climate change. Nye affirms that, "A policy-oriented concept of power depends upon a specified context to tell us who gets what, how, where and when." (Nye, 2011). Therefore, military weaponry should not be the principal basis for power distribution.

IR theorists have mostly centred their focus on strategic raw materials. Gilpin follows this line of thought affirming that one of the main reasons for most wars has been the conquest of important resources, like slave labour, fertile lands and oil (Gilpin, 1981). Morgenthau, on the other hand, considered raw materials, together with food autonomy and other geographical factors, as essential elements of power. In his view, these resources were particularly relevant to build up industrial production and military weaponry. Thus, access to raw materials remains essential to secure national power (Morgenthau, 2003). On the same line, Aron reaffirmed that material resources were fundamental, and once knowledge was added to them, a country would become a power, with the capability to have its will prevail over the others (Aron, 1986). Waltz, similarly, refers to the strategic importance of essential supplies, particularly oil (Waltz, 2002).

Despite these theories, the issue of energy security has played a secondary role. It became more relevant after the first oil shock in October 1973 and the second oil shock in 1979. At that time, the oil crisis was perceived much more as a reflexion of the North-South conflict and the dependence of the industrialized world on strategic raw materials from the so-called Third World (Peters, 2004). Such crises enhanced the concern for energy security.

### «Access to raw materials remains essential to secure national power»

Realists were not able to explain the behaviour of the less powerful or periphery states threatening core states with a commodity, like oil. Classical realists, as Morgenthau, or structural realists, as Waltz, could not foresee the possibility of a periphery state, like Saudi Arabia, to use oil as a weapon, defy the US policy in a strategic region and lead to one of the worst economic crises in modern history. This led Morgenthau to recognize that oil is a powerful factor in global politics that governments should pay more attention to.

The creation of the International Energy Agency (IEA) and an international cooperation regime were based on the liberal belief that cooperation should replace conflict, as the main feature of the international system and that economic interdependence should address the reduction in available inventory of strategic resources. Keohane and Nye recognized that this interdependence could become a source of conflict due to the uncertainties related to dependence on foreign suppliers (Keohane and Nye,

2001). Two main ideas guided their work, in this sense: (i) sensibility, the impact one country has on the other in case of an event affecting it; and (ii) vulnerability, which measures the long-lasting consequences of events and its external impact. Keohane argued that the IEA regime had a positive impact in addressing the issue of vulnerability in 1973 (Keohane, 1984) and was an essential organization during that period.

The oil crisis in the 1970s allowed the international system to create a regime for cooperation in the event of major increase in oil prices.

### «The IEA played a crucial role in building up negotiations platforms and rules to limit the autonomy of governments and other agents, like oil companies»

This regime, as Keohane puts it, helped mobilize “workable coalitions behind political feasible policies” (Keohane, 1984). The IEA regime eventually produced lower prices.

The interest in energy security, however, declined in the 1980s, due to three major factors: (i) a decrease in dependence from oil producing countries; (ii) a more globalized economy, leading to fewer tensions in North-South relations; and (iii) neoliberal ideas with an optimistic belief that technology would eventually reduce oil dependence (Peters, 2002).

Energy security, generally defined as the availability of sufficient supply, however, is a concept that is hard to define (Prantl, 2011). For oil producing countries, energy security is primarily ensuring that governments keep increasing their resource based revenues. Developing countries, on the other hand, seek to avoid the negative impact that oil price fluctuations may have on their balance of payments.

In a post hegemonic world, without a firm international regime, Keohane argues, the prospects for cooperation are bleak. With the ascension of energy-thirsty China, governments should focus on building viable regimes to avoid energy supply problems. The IEA and OPEC should again format the main (yet often conflicting) sets of rules to address these challenges.

## The Role of Oil in the World Order

Oil – realists recognize – is an important hard power instrument. Supply disruptions can be more damaging to economies than wars. Yergin argues, for instance, that the strikes in the oil industry in Venezuela between 2002 and 2003 had a greater impact on supply disruption than the war in Iraq. That is why supply variation and fear are the major driving forces determining the price of a barrel (Klare, 2001). It is the reason why oil can serve as a tool of power, though ephemeral and circumstantial (Nye, 2011).

Oil is a unique natural resource, non-renewable in the economic sense and limited in quantities. Current technology places constraints on the ability to make the resource easily available. Nonetheless, while alternatives to oil are under development, viable replacements are still a long-term prospect, particularly considering current environmental restrictions. This generates dependency, an important aspect of energy security, which is the ability to access enough energy supplies at an acceptable cost. The concept of peak oil plays an important role in the equation (Yergin, 2011). Projections show oil production growing to over 100 million barrels per day in 2040, led by non-OPEC countries initially and from 2020 onward by OPEC. World's natural gas will increase steadily and may reach 5.2 trillion cubic meters (tcm) by 2040. Renewable energies will remain unable to replace oil as a feedstock in transportation. (World Energy Outlook)

As demand grows, due to population and economic growth, energy resources will play a greater role, with the likelihood of more conflicts. Klare foresees three major trends to deplete natural resources: (i) globalization and the fast-paced development of East Asia, which will grow even more, as their income per capita raises; (ii) population growth, and (iii) urbanization and its impact on the environment (Klare, 2000). Thus, wars for natural resources will become the most relevant aspect of international security (Klare, 2001).

**«Control over these resources, particularly oil, will be responsible for this constant race to secure energy»**

Yergin, however, affirms that one of the most important lessons of “the history of oil is to expect the unexpected”. Several factors may be considered to be unexpected: new developments in the industry, a reduction on oil dependence or even environmental concerns forcing

a reduction in the use of fossil fuels (Yergin, 1992). This “surprise” factor creates an environment full of uncertainties.

## The Fall in Oil Prices

The fall in oil prices we experienced in the last few years certainly is part of this “surprise” factor and the dynamic nature of energy markets. This decline in oil prices affected markets, policies, and how the world will move ahead. Developing countries should be able to move faster, highly stimulated by this new cheap oil environment. This is great news for Latin American and African countries who can use this period of abundant and cheap oil to boost their growth rates and increment their development level. Wisdom, nonetheless, is required in order to understand the seasonality of such pricing.

The challenge, then, becomes the future prospects for market rebalance, and how it will play out.

**«The durability of this low oil price scenario depends mostly on the willingness of large low cost producers to maintain the level of the output at the current level»**

An additional challenge is the increasing reliance on the Middle East for imported crude oil and the rebound impact on pricing. Local economic and political instability threats in these countries may lead to sudden changes and influence these markets negatively.

There are several factors behind the fall in oil prices around the world: an increase in supply, an increase in the number of sources, the likelihood of shale oil becoming a direct threat to the oil industry and a clear pathway opening up with the possibility of Iran returning to international oil markets. Additionally, slower Chinese growth has influenced the level of its energy thirst. All this has led oil markets to adjust to new levels in the global trends for oil consumption and pricing. The 2015 World Economic Outlook forecasts a market rebalance at US\$ 80.00 per barrel in 2020 with further increases thereafter.

Issues like continued instability in Venezuela and Iraq, due to their weak infrastructure and institutional framework, and the incapacity of Iran to secure the required investment to keep a steady output growth, however, may affect this rebalancing negatively for those who are on the buy-side of the equation.

As we look into the future, development will require even more energy in order to secure greater economic growth. Securing access to energy is hence quintessential for development, particularly in Latin America, a region particularly affected by the oil crises, and African countries still coping with their domestic turmoil and challenges.

## IEA Expansion

One of the main challenges for energy security is cooperation. The IEA, made up of 29 OECD member countries, plays an essential role for international energy cooperation. Its challenge, however, lies in the absence of major developing countries in the organization. Without them, the IEA is limited in its capacity to secure global cooperation in regards to the implementation of emergency plans.

«The current membership requirement, which is as follows, should allow emerging countries to join and enhance IEA's effectiveness»

Based on the institution's rules, a candidate country must show that it has:

- “As a net oil importer, reserves of crude oil and/or product equivalent to 90 days of the prior year's average net oil imports to which the government (even if it does not own those stocks directly) has immediate access should the Co-ordinated Emergency Response Measures (CERM) – which provide a rapid and flexible system of response to actual or imminent oil supply disruptions – be activated
- A demand restraint programme for reducing national oil consumption by up to 10%
- Legislation and organisation necessary to operate, on a national basis, the CERM and
- Legislation and measures in place to ensure that all oil companies operating under its jurisdiction report information as is necessary.”<sup>1</sup>

The IEA Treaty restriction for membership only limited to OECD countries restrains its outreach and collaboration on issues such as technology and energy policy. There is a need to enhance its role internationally, particularly

with regard to energy security. As an instrument for cooperation in energy security, the IEA should therefore open up gradually to new partners and members. This is even more important as newcomers in energy production and consumption become more active in the international markets.

## A Word on Brazil's Emergence as a New Oil Player

One of the unexpected factors certainly has been the emergence of new oil producing countries over the last decades. The energy potential of Brazil, for instance, may become one of its most valuable assets to increase its global influence and recognition. Brazil, which has gone through major economic and political changes over the last two decades, has been seeking to play a new role in global governance. Maintaining this position depends on the strength of its economy and its ability to become a global player. Since historically the country has over-relied on foreign savings to support its domestic growth, the discovery of oil in its shores could allow it to become a major attraction for financial resources, aiding to transform its influence into effective political power. Despite the financial crisis of 2008, Brazil's positive performance placed the country on a different position, allowing it to reassert itself in a multipolar world as a global actor, particularly at the G-20 level, with a new status in the global chessboard.

«The energy potential of Brazil, for instance, may become one of its most valuable assets to increase its global influence and recognition»

Brazil, nonetheless, wasted too much time discussing the regime for the exploitation of its oil discoveries. Starting with the traditional concession model, the country decided to adopt the partition model, where the Brazilian oil company, Petrobras, would be involved in each process. Years were wasted discussing the issue. The sudden and steady drop of oil prices caught Brazil off guard and postponed its status as an oil powerhouse. The Petrobras corruption scandal that led to the impeachment of President Dilma Rousseff has demonstrated the the company's poor management and how its inability it to lead the process.

(1). See, <http://www.iea.org/aboutus/faqs/membership/#d.en.20933>. Accessed on 05 May 2016 at 18:20.

Had Brazil moved faster, oil could have played a dual role: i) as a provider of economic resources for an emerging country; and ii) as a tool of foreign policy considering the energy security needs of a bipolar world order with the United States and China as the main players.

«A more intensive exploration of shale oil and gas, together with the increase in oil production by other oil-producing countries, have altered the preeminent role oil plays in the Brazilian economy»

At least for a while, oil will not catapult Brazil from its middlepowermanship to an influential position in global governance, despite Clemenceau's affirmation that "oil in modern society is like blood in the human body."

## Prospects for Cooperation and Policy Recommendations

The world needs more collaboration and open markets in energy policy, which is always at the centre of the toughest challenges the world faces.

For a while, the abundance of oil and other energy generating sources were deemed as a resource curse. This is not true. The resource is not a curse but its poor management is.

Energy is directly linked to governmental capacity to generate economic growth, employment and technology. Countries depend on energy to secure a better future. The stability of energy markets is quintessential for a peaceful evolution of the international system. It is an area where multilateral cooperation is extremely necessary. With newcomers in oil production, such countries should be included in a way that oil is used for the greater benefit of mankind and not just a privilege for the few.

Energy collaboration is essential for energy security. Energy governance requires new structures to ensure greater collaboration.

Therefore, the following policy recommendations are essential to secure energy security:

1. The IEA should expand by including members from developing countries to ensure a bigger reach of best practices regarding energy cooperation.
2. Developing countries without access to oil resources should take advantage of the current cheap oil prices in order to increment growth and with such savings, to secure the necessary resources for the times of price rebalance, which is likely to occur in the future.
3. Oil producing countries should re-examine their own policies in the light of their current use of oil resources to cope with the growing number of oil producing countries.
4. Countries that have discovered oil reserves should improve their ability to produce within a competitive legal framework with a clear understanding that oil may not provide as many financial resources for them in the future as they may think.
5. Military power, for global governance purposes, should not constitute the main factor for power in the global chessboard, since energy security is at the core of implementing any hard power strategy. The international system should widen its perspective on hard power to include not only economic and military capacity, but also the capacity to secure energy supplies as a tool for economic development and growth.
6. In case the IEA is not willing to expand its membership, developing countries should establish cooperation mechanisms, instruments and an organisation to secure energy cooperation.

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