A New Perspective on Energy Security

*By Robert Priddle**

My theme is energy security. That will come as no surprise to those of you who know the origins of the International Energy Agency (IEA). Our founding fathers created the Agency in order to contribute to greater international energy security, especially oil security. That remains our core role.

Yet it is fair to say that, in the 1990s, the (now) 26 member nations of the IEA looked to the Secretariat for public policy analysis and proposals largely in other areas. Their preoccupations, then, were the pursuit of greater economic efficiency in the energy sector, through deregulation and the introduction of competition into gas and electricity markets, and how best to tackle greenhouse gas emissions from energy production and use. Oil security was rather taken for granted. And there was little reason to be concerned about energy security more generally, at least in terms of the availability of the necessary primary resources: the presumption of abundance was, indeed, confirmed by the IEA's work on supply prospects for the next 20 years, published in the World Energy Outlook series last year, under the by-line "Assessing Today's Supplies to Fuel Tomorrow's Growth".

So, what has changed? Why is energy security back at the top of the agenda? Our minds spring automatically to September 11 last year. There is no doubt that the terrorist attacks on the United States have significantly changed the world. A spate of conferences has sought to analyse exactly how. Typical amongst them was one at the London School of Economics in April under the title: "A New World (Dis)order".

In the fuel markets, the appalling events of September 11 led to an immediate surge in the oil price, reflecting fears of repercussions which could threaten oil supply. That price reaction was very short-lived; and it was followed by a sharp price fall. But the immediate effect was a heightened sense of vulnerability – and of solidarity in the face of unforeseen horror. The Secretary General of OPEC immediately announced OPEC's readiness to make good any lost oil supply – a significant assurance, to which I shall return. For its part, the International Energy Agency geared up to act, tailoring its emergency response readiness to the new circumstances.

We have now had a little time to take stock of September 11. It was, certainly, an appalling and grave event. Energy installations everywhere have had to move to a higher state of alert. We have seen anti-aircraft missiles deployed around the nuclear fuel processing plant at La Hague. The vulnerability of gas terminals, gas pipelines, oil installations and generating plants has been reappraised. Last week announcements were made in New Jersey and Pennsylvania about the distribution of potassium iodide pills to those living within 10 miles of nuclear plants, as a safeguard against thyroid cancer. The President has signed a bill that requires such pills to be available to all Americans living in the vicinity of nuclear plants.

Beyond the United States, the world is, evidently, more at risk. Events in Afghanistan, Iraq, Israel and Palestine, Pakistan and India all had, or have, the potential to disrupt world peace or, at least, world trade, especially trade in oil. Iraq's suspension of oil exports in April followed the first overt call to oil producers for many years to use oil as a weapon to shape political events. The idea – but not the reality – found an echo in Iran and Libya. The stability of the regimes of the Persian Gulf, especially the Kingdom of Saudi Arabia, came under new scrutiny as the dominant nationality of the September 11 hijackers became known.

These are, indeed, grave events and grave threats. But the geopolitical risk to continuity of oil supply is, in itself, nothing new. These are but current, concrete examples of the known geopolitical risk, against which the governments of the industrialised world decided, over twenty five years ago, they must protect their citizens. On the other hand, the terrorist threat, in the form perpetrated in the United States, is indeed new. The actual and potential consequences for peaceful, local communities are appalling. But the direct and immediate effect of such terrorist action on energy supplies would be essentially local. International markets would flicker, but not be fundamentally disrupted.

So we have to dig deeper to account for the renewed, world-wide anxiety about energy security. One important indicator is that this renewed concern pre-dates September 11. Energy security was already the main focus of discussion when IEA Ministers met in May, 2001. Commissioning the National Energy Review had been one of the first actions of the incoming Bush administration. The European Commission was consulting its member states and others throughout last year on its Green Paper on energy security in the European Union.

The Californian energy crisis in late 2000 and early 2001 was one precursor. Interruption of electricity supply and fluctuations in the price of both electricity and gas beyond the range with which consumers could reasonably be expected to cope – beyond, indeed, the capacity of major players to survive – sent shock-waves through the system.

But the origins of the new political preoccupation lie further back still. The year 2000 had seen mounting concern on the part of oil consuming countries about excessively high crude oil prices. This was the year of Energy Secretary Richardson's constant, highly-published perambulations around OPEC producers in pursuit of commitments to increase oil supply. By September, discontent about the price of oil products, expressed through direct action by truckers, fishermen and others, starkly confronted governments in Europe, winning a variety of tax and other concessions. In February of 2001, the Australian government abandoned routine excise duty uprating in the face of similar protests.

The protestors' fire was directed as much at the taxation policies of consumer governments as it was at oil companies and, behind them, the producing governments responsible for high crude oil prices. Oil producing states had done a good job in 2000 in drawing attention to the high proportion of taxation in the final price of many oil products, especially in Europe. But, while some governments in consuming countries had, indeed, adopted policies of successive, real increases in oil product taxation, in pursuit of environmental objectives, the proportion of taxation in the gasoline price had actually fallen in Europe in 2000 in the face of the rise in the crude oil price. Governments of oil consuming states had some justification for feeling that their electors' wrath was

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The high crude oil prices of the year 2000 stemmed from OPEC's newly-refound authority in the market. Perversely, that, in turn, stemmed from OPEC's disastrous misjudgment, late in 1997, to increase production quotas just as the Asian financial crisis began to bite deeply into oil demand. The consequence of that was the price collapse of 1998, which persisted into 1999 until, at the third attempt, OPEC and some non-OPEC producers convinced the market that they were serious about cutting production back and could be relied upon, more or less, to fulfil the commitments they had made to each other in this respect. This was the classical tea-bag effect in operation. OPEC is like a tea-bag. It only works when it is in really hot water.

Unfortunately, attempts to manage the market by governments acting collectively, in meetings held at irregular intervals and preceded by much publicity, are highly imperfect. Governments are also, by nature, unadventurous. They look back, rather than forward. The newly-disciplined OPEC production cuts were biting as oil demand began to take off again, stimulated by the low prices of 1998 and early 1999. This lead to the price peaks of 2000 and the consumers' anguish to which I have referred.

The Californian experience then came piling on top – the consequences of an ill-designed competitive regime, superimposed on a previous regime which, for years, had given inadequate incentives for new investment in generation capacity. Inappropriate price caps triggered supplier bankruptcy. The regime appears to have encouraged manipulative trading. Gas demand soared and gas prices, too. All this was enough to sow serious doubts in the minds of legislators and the public about the desirability of the process of market deregulation, in the USA and elsewhere. Could the new, competitive markets be relied upon to maintain short-term supply reliability, at a reasonable price, and secure the necessary flow of investment to provide the capacity to meet future demand growth?

Our answer, in the International Energy Agency, is, largely, yes. We derive this answer from analysis of the performance so far of competitive electricity markets around the world. We published our findings last week in a book entitled "Security of Supply in Electricity Markets – Trends and Issues". Despite all the attention which California has received, the international picture is reassuring. Where electricity prices have been appropriate, as in the UK and the Northeast of the USA, abundant investment has flowed into the electricity market. Generating reserves have declined following market liberalisation. This is no surprise. One of the objectives of liberalisation is to achieve greater economic efficiency by eliminating over-capacity. But reserves have generally remained robust.

But this is retrospective analysis. It wasn't available when the lights were going out in California and prices were soaring beyond reasonable levels. The process of deregulation then came into question. Couple this with soaring gas and oil product prices, new OPEC confidence in its powers of market management, new global conflicts and then a new, specific terrorist threat and its is no wonder that governments are looking again at the basics of energy security. This preoccupation extends beyond the OECD countries. ASEAN is reviewing its mutual oil emergency commitments, with the determination to give them new reality. ASEAN + 3 (ASEAN + Japan, China and Korea) are debating emergency arrangements. The Chinese government has committed itself to build oil emergency stocks and is drawing directly on IEA experience. The need for action in this area was a recurrent theme at the Asia Oil and Gas Conference in Kuala Lumpur earlier this month. Governments have never doubted that national security is their responsibility. They have been starkly reminded that their responsibilities extend to energy security, even in liberalised markets.

That reminder is no bad thing. It will bring conflicting policies into better balance. But I do not want to give the impression that the picture is all black.

I have said that analysis of primary energy resources shows that reserves are plentiful – though largescale mobilisation of financing is necessary to turn reserves into available supplies. The process of deregulation is proceeding, despite California. Iraq may have cut oil production for political reasons; but its action had practically no effect on the international oil market. Indeed, that action provoked one of the most forthright recent affirmations, by an oil supplier of producers' commitment to maintain the reliability of supply. "Oil is not a weapon. Oil is not a tank.", said the Saudi Foreign Minister on 19 April. And I remind you again that the first action of the OPEC Secretary General, Ali Rodriguez, when news broke of the September 11 attacks, was to assure the market that producers would make good any oil supplies which might be lost.

What this reflects is a new maturity in the relationship between oil producers and oil consumers. Late in 2000, in Riyadh, Ministers from oil producing and consuming states met for the seventh meeting of the series started early in the 1990s (now known as the International Energy Forum). That meeting came at a propitious time. The year had seen extensive bilateral contacts between consumers and producers. The U.S. Energy Secretary attended the Forum for the first time ever: he could hardly do otherwise. Though price and production control were forbidden subjects, as always, the underlying issues were addressed with a new directness. And when the Saudi Crown Prince proposed that the time had come to give the dialogue some institutional permanence, there was no dissent. That initiative is expected to mature in September in Osaka, at the eighth meeting of the International Energy Forum. Producers and consumers will create a joint secretariat to underpin future work. They will review – and not doubt extend – successful joint efforts over the past two years to improve the topicality and accuracy of the demand, supply and stock data available to the market (the Joint Oil Data Exercise – JODE).

Looking to the future, what the experience of the last few years has done is to rebalance government energy priorities. Environmental issues remain important. So, too, is the pursuit of greater economic efficiency through deregulation and the introduction of competition. But the third pillar, energy security, is now restored to its rightful place. The energy contribution to sustainable development rests on all three pillars. This message is not welcome to all – for example, some members of the single-issue environmental community. They don't like its starker forms of expression, for example, in the United States. But it is a message which the entire IEA community has agreed to promulgate and will be seeking to see reflected in the outcome of the World Summit on Sustainable Development in Johannesburg in August.