

The Geopolitics of Oil and Gas

By Fred B. Olayele*

The importance of energy as a major driver of economic activity, and by implication a basic denominator of growth, is well explained by history – especially with regards to how the world's energy use pattern has evolved over the years. Changes in oil prices and availability continue to affect economic growth prospects, international security and political stability of consuming countries. To a large extent, many contemporary regional energy-driven contentions – among producing, transit and market states – determine the world's energy security architecture. While many industrialized economies are working aggressively to develop alternative non-oil based energy sources, their emerging counterparts continue to rely on relatively cheaper hydrocarbon-based energy sources to increase their productive capacities, at least for the foreseeable future.

According to the International Energy Agency (IEA), global demand for energy is expected to rise by one-third by 2035 as economies in both developed and emerging countries continue to grow and standards of living improve. In the past – and perhaps for years to come – the global energy security architecture has been geared to the needs of the Western market. However, with recent population forecasts showing Asia as a centre that will host nearly half of the world's urban population, with a concomitant increase in oil consumption, the gradual shift of global energy trade to this region will have many geo-strategic implications.

Energy Prices

Many factors explain 2014's global slide in oil prices, chief among which are increased American and Canadian production, increased energy efficiency, economic stagnation in Europe, slowing economic growth in China and Saudi Arabia's refusal to help stabilize price by cutting production. Among other things, many in the field of energy economics agree on one thing: that energy prices are determined by a complex interplay of economics, geopolitics and technological changes. Not only that, there is a consensus that global oil and gas prices are an important economic indicator for firms and households, since they affect inflation, purchasing power, and industry's production costs. Since it reached its peak in mid-June this year, the price of oil has declined by 40 percent. This plunged further last week after the Organization of the Petroleum Exporting Countries (OPEC) resolved to continue to produce at the same rate, in an effort to squeeze out some of the marginal producers in the fast-growing U.S. oil industry. Given the weak state of the global economy and increased domestic energy supplies in the U.S., tumbling oil prices continue to drain hundreds of billions of dollars from petroleum producers, exporters and oil companies. On the other hand, lower prices play to the advantage of many European countries, the U.S. and Japan by shifting hundreds of billions of dollars into stimulating their economies as household demand continues to pick up.

Falling oil prices continue to push down already low inflation rates, thereby delaying the need for monetary authorities in many countries to raise interest rates even as growth picks up due to rising household spending on non-energy products. While this presents an opportunity, there definitely are some offsetting negatives. The IEA said recently that about \$900 billion per year in investment will be required in the upstream sector to meet energy demand between now and 2030. Interviews and surveys from many oil and gas headquarters around the world show clearly that the current environment is unlikely to encourage that level of capital investment, given the oil wealth transfer to consumers from current low prices. It doesn't stop there. A lower-than-expected level of investment has far-reaching economic implications, including the likelihood of a global economic slowdown further down the road when global oil prices may rebound to yet higher levels than earlier this year in order to incent oil investments. Again, understanding the geopolitics of energy is strategic to escaping the conundrum just presented above.

From Moscow to Baghdad, from the Middle East to Asia, recent happenings show that regional disagreements that ordinarily would have been handled by regional powers have now begun to increasingly attract global interest, with some of the most powerful countries in the world intricately involved. The reasons for this are obviously not far-fetched. For instance, the recent crisis in Ukraine explains the importance of energy in the global geopolitical matrix, as well as why and how energy will continue to be a fundamental indicator of national power.

Pipelines

Understanding the strategic importance of pipelines in the global petroleum geopolitical equation is key. Because they help diversify a region's petroleum

* Fred Olayele is a Senior Energy Economist, in the Ministry of the Economy in the Government of Saskatchewan, Canada. He may be reached at fredb.olayele@gov.sk.ca

supply routes, in addition to connecting trading partners and influencing the regional balance of power, pipelines are more than a mere medium of resource transportation. Europe is served by a pipeline put in place up north by Russia. Economic ties remain one of China's most potent instruments in Central Asia. In fact, it would not be out of place to say that one of the most 'political' Chinese investments in Central Asia are the pipelines; the Turkmenistan-China gas pipeline – which passes through Turkmenistan, Uzbekistan and Kazakhstan – delivers gas into Xinjiang. The Chinese have a pipeline going as far as Shanghai and connecting with their network east. While these pipelines generate great economic benefits to the participating regions, Beijing is able to significantly shape the direction of many Central Asian states' foreign policies by leveraging its economic clout.

The more than a decade-old proposed Turkmenistan-Afghanistan-Pakistan-India (TAPI) pipeline project is another vivid example of how the rapidly changing global energy geopolitical landscape continues to play out. Estimated at \$10 billion with the capacity to transport 33 billion cubic meters of Turkmenistan gas over 30 years, important security and financing concerns through Afghanistan have been a clog in the TAPI project's wheel of progress. Recently, the TAPI countries decided to begin constructing the pipeline by 2016, with completion estimated for the end of 2018. With the Asia Development Bank recently designated as transaction advisor, hopes are high again that the 1,800 km pipeline project may see the light of the day. The one question that remains on the lips of many is how Sino-American relations might have impacted the political chess game of the project. While the Americans favour it, the Chinese are skeptical. A successful completion of the project will imply total avoidance, or at least, a reduction in total dependence on Chinese gas purchases. The U.S. position is relatively easier to understand – increased U.S. oil and gas production has had a profound impact on the country's position in global energy markets – more so than at any other time in decades. Nonetheless, the Americans continue to watch and assess events on the global energy geopolitical stage, and from time to time, react to suit their economic and national security interests.

The proposed Keystone XL pipeline by TransCanada has become another reference point in the complex interplay of economics, geopolitics and technology. While advocates believe that increased flow of Canadian oil into the U.S. will lower gasoline prices, strengthen energy security and generate substantial economic benefits, pipeline opponents cite environmental consequences, including climate-warming greenhouse gas emissions. While both views have their merits, the global commodity status of oil makes this argument more a function of global economics, geopolitics, security and technology than any other thing.

Recent Geopolitical Developments

While the impact of economics on many of the geopolitical decisions by governments across the world is well understood, many are concerned that political insecurity and uncertainty could negatively impact global energy and trade dynamics, leading to another global economic meltdown. The important role that Russian energy plays in European geopolitics has again been highlighted by the Crimea crisis and moves against Eastern Ukraine. Almost one-third of Europe's natural gas supplies come from Russia; half of Ukraine's natural gas needs are met by Russia. Given such a delicate demand and supply picture, there is no gainsaying the fact that energy is central to the political and economic turmoil in Ukraine. After more than two years of discordance on price, coupled with worsening Russia-Ukraine relations over Moscow's annexation of Crimea and fighting, Russia finally cut off gas supply to Ukraine. An interim gas deal recently brokered by the European Commission for Moscow and Kiev should help Ukraine receive enough supply to get through the winter. Contentious debt figures between both countries do not help matters either; Ukraine says it will honour its debt obligations with Russia only after the International Court of Arbitration in Stockholm delivers its verdict.

Russia remains one of the world's most resource-endowed jurisdictions – it is the largest natural gas exporter and one of the two largest producers of crude oil. While the country's oil resources constitute an economic lever, Russia uses its abundant natural gas to remain politically relevant in the global sphere. With a new wave of Western sanctions hitting Russia's economy hard, coupled with falling oil prices and its currency at a record low against the dollar, it remains to be seen whether or not President Vladimir Putin will pull a new set of policy levers.

Elsewhere, the Saudis are taking charge in the rapidly changing face of the Middle East. As the world's largest oil exporter and second largest producer, Saudi Arabia's unique position allows it to dramatically influence global economics and politics. While Saudi Arabia, Kuwait and United Arab Emirates have the financial muscle to voluntarily reduce oil production, the other OPEC members – Nigeria, Libya, Algeria, Iran, Iraq and Venezuela – rely on maximum production and high prices to finance their

budgets. For instance, the Saudis are not interested in a nuclear deal for Iran, and neither are they happy with the U.S. for endorsing this policy choice. Because Israel is very sensitive about a nuclear deal with Iran, the Israelis and the Saudis have a common destiny here, notwithstanding the divergent views of the Americans on this issue. This might explain, in part, why Saudi Arabia will always prioritize a greater market share over higher prices.

The U.S. continues to import oil from the Middle East, despite its rising domestic production. The Americans maintain that increased domestic production is not enough to deter America's strategic relationship with the Middle East. Oil imports by the U.S. from Africa have also taken a nosedive, and again, America says that its interests in Africa will not change despite the dramatic fall in oil imports from the region. To minimize the economic and fiscal costs of reduced exports to the U.S., major African oil-exporting countries like Nigeria, Algeria and Angola have diverted their oil to other growing Asian countries and European markets. Although the U.S. says it cherishes a free and uninterrupted flow of energy to its allies and trading partners, these happenings all have significant geopolitical implications that will be manifest in the years ahead.

Conclusion

The rapidly changing global energy picture will continue to determine what policy and strategic choices producing, transit and consuming countries make. It has become clear that U.S. foreign policy – which sways global economics and politics – is significantly influenced by energy security, as demonstrated by the continual shifts in markets. Increased domestic oil production has changed the position of the U.S. in the global energy markets. In turn, this has huge implications on European policies, maybe not so much with respect to its strong and traditional allies – but at least with Russia and its neighbours. Rapidly growing Asian and African populations, which place a huge burden on hydrocarbons, portend grave concerns on climate change. Again, countries will have to rely on the interesting, but complex, interplay of economics, geopolitics and technological changes to successfully navigate these waters.

References

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