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Building Long Term Energy Security: *Seize the Moment*

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This moment of global crisis, with the world economy contracting, commodity prices falling, and credit markets frozen, provides a unique opportunity to lay the groundwork for long-term energy security and more peaceful international relations. For decades global energy markets have been prone to extreme cyclicity, which is bad for the global economy, undermines efforts to effectively address climate change and impedes stability. The tendency for the party benefiting at a particular cyclical phase, be it a government or a company, to overreach in pursuit of their interests, and a resulting zero-sum impact on energy security exacerbate the cycle.

The most recent price cycle demonstrated that the current institutions of global governance, from the International Energy Agency (IEA) and International Monetary Fund (IMF) to the Organization of Petroleum Exporting Countries (OPEC), to the International Energy Forum (IEF) and national commodities regulators, lack the capacity to muster consuming country cooperation on sustainable investment or national security policies, let alone international cooperation to monitor and address large global movements in energy markets. The cycles inherent in energy markets, in short, impede sustainable efforts to reduce their impacts and reinforce their internal dynamics, leading to extremes.

With energy prices low, producers under pressure, and global financial institutions in search of ways to reduce systemic risk, now is a prime opportunity to consider new approaches to global energy governance and new foreign policy strategies. The window is short. Prices are low now, but demand will rebound and with it the economic and political risks that paralyzed policymakers just a year ago will resurface. This may leave no more than two or three years for effective action.

Following the election of Barack Obama and his early focus on clean energy and environmental policies, the US is seen as a more credible energy partner. However, the Administration's emphasis on the relationships between environmental and energy policy could distract the White House from taking advantage of this low price environment to reform global energy governance and improve relations with oil and gas producers. In order to seize the opportunity, more attention needs to be given to traditional oil and gas issues.

In this report we briefly review what drives these cycles of boom and bust and how policymakers have (or have not) taken advantage of this volatility to foster change. We outline the lessons learned from the most recent high price cycle and why there is a window of opportunity to make structural change now. We then recommend a program of reform of global rules and institutions that could produce more equitable and sustainable bargains for producers and consumers, whether governments or companies or individuals, in the long run and more transparent and efficient energy markets. We also offer strategies for enhancing US national security by renovating our relationships with key energy suppliers and consumers.

Booms and Busts

Energy markets have experienced several boom and bust cycles since the 1970s. This volatility has largely been driven by politics, technology and market imperfections. Many of the price spikes have resulted from supply losses caused by international conflict or internal unrest. The Arab oil embargo of 1973, the Iranian revolution in 1979, the Iraqi invasion of Kuwait in 1990 and the US invasion of Iraq in 2003 are clear examples. More recently, the collapse of anticipated production growth in Iran, Iraq, Nigeria and Venezuela coupled with the unanticipated surge in petroleum product demand in China, India and commodity producing countries, produced enormous price spikes that were higher than would have occurred with better information. This was due in part to the lack of timely consumption data and the existence of giant, opaque and largely unregulated markets. On the other hand, price collapses have largely been the result of economic contraction due to higher prices, the accumulated impact of new investments and technological changes. For example, sharp improvements in fuel efficiency and breakthroughs in the ability to find and produce oil in the 1980s led to excess supply.

Creative destruction. At times, this volatility has prompted producing and consuming governments to undertake meaningful reform. The price spikes following the 1973 Arab oil embargo produced a system of collective energy security that has deterred subsequent embargoes, led to the development of strategic reserves, and sparked improvements in efficiency and technology that still reverberate today. Bottlenecks in the ability of companies and governments to re-balance their oil stocks in the 1970s led both to the development of spot markets for the trading of oil and products and to the development of coordinated stock draws as an emergency response mechanism by the IEA.

The relatively low price environment of the mid 1980s and early 1990s led to openings for foreign investment that drove production booms in Russia, the Caspian and West Africa, fostered policies to diversify oil-based economies to other industries among the Gulf Cooperation Council countries, and created a welcoming environment for political accountability and revenue transparency in parts of Africa and the Caspian region. As a result, the IMF and World Bank began to incorporate environmental sustainability and fiscal management standards into their lending programs. Global initiatives like the

Extractive Industries Transparency Initiative were launched to empower citizens to hold their governments accountable by verifying and publishing the amount of revenue earned by governments from oil, gas and mining. Furthermore, energy producing governments adopted fiscal rules to limit their spending and develop reserve funds to compensate for future commodity price drops.

Destructive destruction. Other times this volatility, especially when prices are high, leads to excessive behavior that undermines production capacity and poisons international relations. Market participants tend to overreach when they are ascendant, creating unsustainable bargains on how to share risk and reward. In addition, governments lose interest in reform when economic crises recede – usually too soon to accomplish lasting reforms.

Periods of high prices typically lead producing countries to seek greater rents from the resource base resulting in reduced access to supplies as evidenced by the widespread nationalizations in the 1970s and a return to resource control policies during the most recent price spike. In addition, high prices bring greater political instability as high revenues emboldened producers to undertake more aggressive foreign policies, using hydrocarbons as direct instruments of policy and using windfall hydrocarbon earnings to consolidate power at home and to wield it abroad. In the 1970s there was the Iraq-Iran war and the Russian invasion of Afghanistan and in the 2000s this intensified with more antagonistic behavior by many producers including Russia, Iran, and Venezuela. The latest cycle demonstrated that the greater the revenue flow, the more producers acted with impunity. Instability inevitably follows suit as prices change direction suddenly, unexpectedly and violently on the way down just as they do on the way up.

The Last Cycle

In 1998, a price crash precipitated by the Asian financial crisis, the return of Iraq to the global market as an exporter, an unseasonably warm winter and the failure of OPEC to adapt to these shifts in demand, and indeed the battle for market share in the US waged by Saudi Arabia and Venezuela, led to a major price crash. The political impacts of this price crash were powerful. Venezuela suffered a major budget crisis, leading to the election of Hugo Chavez on a populist platform. Russia's financial collapse led to the privatization of its oil industry, the introduction of foreign capital and the beginning of a drastic restoration of Russian oil production.

Many of the bargains struck in 1998 were not sustainable because they heavily favored foreign investors that were willing to carry the geological and market risk but did not provide an adequate mechanism for host countries to significantly share in additional revenue in at higher prices. In fact, the failure of governments in the industrial world to help share the drastic burden of adjustment confronted by poor oil producing countries as their revenues suddenly halved, inspired them to break these bargains once prices rebounded and to ignore pleas to raise output as prices started escalating after 2003.

As prices recovered, host governments reduced access for foreign investment. Many, like Venezuela, Algeria, and Russia insisted on taking majority shares, which were to be financed by the excess revenues of national oil companies. Some governments, like Russia, determined that they could fund exploration through their own national champions and service companies. The result was that production began to lag as early as 2007. Rising demand in China and the rest of the developing world produced a demand shock which the market did not foresee and which private capital could not keep up with. Prices also led to an unprecedented shift of investment capital into oil as a commoditized financial instrument. Imperfect information, herd behavior and largely unregulated markets in the trade of oil helped drive a boom to historic highs. This boom collapsed more rapidly than anyone expected, creating the current bust cycle.

The most recent cycle of high prices interrupted the movement towards greater transparency, accountability and cross-border cooperation. Flush with cash, producing countries felt less pressure to improve governance and modernize their energy sectors. At the same time, consumers and international oil companies (IOCs) moved away from collective action and towards individual relations with producers in order to strike a better deal. This beggar-thy-neighbor approach further emboldened producers and broke the momentum towards greater openness forged in the late 1990s. This stands in stark contrast to the political unity that followed the oil crisis of the 1970s when the IEA was formed. The super cycle also showed how the commoditization of oil swamped the ability of regulators to monitor these flows, leading to some irrational and destructive behavior.

Today's Window of Opportunity

As grave as the security threats from petro-states are, governments lose focus when prices recede. Crude oil prices have dropped by two thirds from a year ago. But this period of low crude oil prices, like the low prices of mid 1980s and the late 1990s, and the super cycle of high prices in 2007-2008, is certain to change. The salience of crude oil and natural gas to the global economy, as a source of transportation fuel and the key feedstock of power and heat for much of the world, remains the same. American foreign policy, its ability to forge coalitions to wage war and build a new nation in Afghanistan, to stabilize Iraq, to contain Russian ambition, to protect open markets and democracy in Latin America, to support the evolution of China and India as responsible stakeholders, all still depend on the ability of nations to access long term supplies of hydrocarbons, at reasonable prices, free of economic or political coercion from their suppliers. In short, oil and gas still matter.

Low prices provide a unique opportunity to enhance US energy security. Low prices and low revenue make producing countries more willing to engage with consuming countries to attract foreign capital to develop their reserves. Low prices allow countries to negotiate for open access and unimpeded transit of oil and gas across national borders, such as across Russia and the Caucasus. A low price cycle, combined with the global financial crisis, revives the importance of international financial institutions (IFIs) to developing resource dependent countries, enabling the IFIs to urge revenue and expenditure transparency as a condition of their loans and grants. Low prices also constrain the budgets of energy exporting countries, giving them incentive to explain the budget impact to their public as spending declines and to exercise greater care in how they spend public money. Finally, low prices reduce the intensity of the competition between established western consuming nations and China, India and developing Asia, providing the chance for all consuming nations to find common ground for cooperation in securing long term access and stability of supply, and reducing the cost of rejecting energy supplies from nations that disrespect international rules of peace and security.

In addition, the US is currently seen as a more credible energy partner. The election of Barack Obama has lifted America's image abroad, and new policies have opened the doors of engagement with long time adversaries, such as Iran, and reinvigorated efforts to resolve long standing conflicts in the Middle East and South Asia. America is leading at home in the effort to improve energy efficiency, advance renewable energy supply, and construct a national cap and trade program.

This window of opportunity will likely be short. We are now rapidly sowing the seeds of the next oil boom, and increased global dependency on OPEC oil. Oil at \$40 has already led to a slowdown in new investment in Canadian oil sands and other energy projects. By the time demand recovers, perhaps as late as 2010 or 2011, a supply gap may emerge which could take another five to seven years to fill. Market control will shift back to OPEC, and political power will shift back to the petro-states, such as Iran, Venezuela, Russia and soon Iraq. This looming new oil boom is the reason why it is urgent to act now, while limited but valuable leverage remains.

Rethinking Global Energy Security

Energy markets have changed dramatically in 30 years. Global institutions of governance have not kept up. There are new players on the consuming side, China, India and developing Asia, and fewer players on supply side, as national oil companies dominate an increasing level of reserves. The lack of integration of energy and foreign policy has produced suboptimal results for US foreign policy. We need a fresh approach.

Long-term global energy security, providing ample supplies of oil, gas, and alternative fuels to consumers free of economic or political coercion, requires a reinvention of the institutions of global energy governance and a reinvention of the US approach to energy and foreign policy.

Global Energy Governance. The goal of a new system of global governance should be to expand the reach of collective energy security and create rules and institutions that can expand the number of countries that produce energy, reduce monopoly control by any one supplier, and create transparency, predictability and security in global energy markets. The new system and new rules need both to account for traditional market participants and to relate to the legitimate calls by both Russia and China to be recognized as significant global energy and political players.

1. *Expand Collective Energy Security.* The first step is to expand the reach of the collective energy security system founded on the International Energy Agency (IEA). The IEA, which once held the majority of the world's energy consumers, no longer does. China and India belong in any effective collective institutions, and perhaps other major consuming countries. The inclusion of non-OECD countries in the IEA requires an amendment of its charter. China and India have reportedly been loath to join a club

whose rules were established by the Western OECD club of nations. Two ways to draw China and India in are to develop a new, stand-alone charter for the IEA that does not require OECD membership, but retains the requirements to establish strategic reserves and participate in a coordinated emergency response mechanism. The other is to revise the existing charter to allow for exceptions to the OECD rule and make a firmer diplomatic effort to persuade major consuming country members to join.

2. Modernize the IEA mission. The IEA should expand its mission to address new threats to energy supplies. First, the IEA should evaluate the current market circumstances under which its emergency response mechanism is used and whether it makes sense to expand the mandate to cover situations where prices increase dramatically without a clear physical supply loss. The IEA must also intensify its role in providing global gas security and review ways to respond to short-term gas supply disruptions, including a shared gas stock mechanism. This will become increasingly important as global gas producers enhance their own cooperation. To reinvigorate the role of IEA as the primary international energy organization, the IEA should convene a Heads of Government Meeting. While energy issues are sometimes discussed at G8 Leaders Meetings, they are largely overshadowed by other economic issues.

3. Utilize the IMF and World Bank. US policymakers should work through the G-7 and the US Executive Directors of the Bank and Fund to ensure that the IMF and World Bank, which will likely have a lead role in developing country infrastructure, stay engaged in energy development and apply standards of good governance, revenue and expenditure transparency, and improved capacity for energy ministries. When the Bank invests in transportation infrastructure, it might look at ways to incorporate rules on open access into its financing requirements. The US should consider asking the IMF to add reporting on energy demand and production into IMF Article IV requirements, so the IMF's evolving market surveillance function includes trade in energy.

4. Establish new rules for trade and transportation of energy. At the time of the cycle that unfolded and grew to its peak in the 1970s, the OECD countries not only had national champion oil companies (with the notable exceptions of the US and Germany), but most of them had severe price and other controls on fuels and linked energy to other foreign policy objectives. When low oil prices ensued in the 1980s, they de-regulated their markets, sold off their state-owned firms (with the exception of Norway, which treats its NOC, Statoil, on equal footing with national and foreign firms), and facilitated cross border flows of fuels and investments in energy. While the system is still imperfect, the world of the OECD stands in stark contrast with what happens elsewhere. Now is an opportunity to expand the rules and regulations governing energy ties within the OECD and to the rest of the world. The aim would be to encourage the retreat of government from the energy sector, in order to establish a wider arena of win-win non-zero sum relations to replace the win-lose atmosphere that otherwise prevails. Many benefits would ensue, including greater and more efficient development and use of energy.

Both the model and the mechanisms to achieve this new environment exist. The model is predicated on reciprocity, national treatment of foreign investors, the guaranty of third party transit rights, guarantees of competitive practices, including rights to re-sell purchased fuels (natural gas as well as oil and oil products), and most importantly in today's world, establishment of credit rules for financing international investments. The model could be either reviving the Energy Charter, with specially crafted inducements for Russia, or via full extension of the WTO to trade in energy. But the Energy Charter could serve as a better foundation, with its emphasis not only on trade, but also on third party transit and on competition rules.

A challenge is providing sufficient inducements for Russia to agree to terms that would limit its ability to withhold natural gas from the market and would also limit its preferential treatment for Russian firms. Today's low price environment could provide the foundation for a set of inducements to Moscow. Certainly, after being rebuffed by OPEC in recent months, Moscow must surely realize that its future lies with growing markets and tying down its current European market base, which the country has increasingly impacted as an insecure supplier. The Russian leadership must surely realize that infrastructure will tie it for decades to Western buyers. Additionally, if the OECD countries – via the G-7, IEA, or some other mechanism – understand that their interests vis-à-vis Russia are better served by collective rather than bilateral efforts, they could move toward assuring these objectives. For example, a creditor agreement should be put in place whereby renegotiating old or providing new credit facilities to Russian companies should be tied to full reciprocity and national treatments as well as to investments in new energy resource developments rather than purchases of assets within Western markets. Additionally, with so much of Russia's new resource base in frontier exploitation areas, whether shale gas or deepwater, reciprocity could bring in foreign capital while also assuring Moscow and Russian firms that they will gain unfettered access to Western markets and assets, enabling them to be giant firms at home and abroad.

Inducing China and India to join in a global commercial energy organization should be a good deal easier than inducing Moscow. Both are market based countries; both understand the limits of state intervention via national oil companies; both understand that their future growth is tied more to the perfection of markets than to a neo-mercantilist world in which statist interventions are likely to be expensive and self-

defeating at the end of the day, a lesson long ago learned within the OECD.

What's more, Russia need not be the only producer country that might find it beneficial to participate. Brazil, as might other non-OPEC countries (E.g. Egypt), and some OPEC members too – and the main OPEC North African producers would be likely candidates, given their existing integration into the European market.

5. Modernize regulation of commodity markets. Significant momentum was built in mid-2008 toward increasing transparency in the commodity markets. Much of that momentum was the result of escalating prices and fears of market manipulation. Even if the debate about the precise impact of financial investors is unresolved, there is little doubt that the evidence is overwhelming that financial flows influence the magnitude of price changes and of price volatility. Given the rapidity and the degree to which prices fell in the last half of 2008, some of that momentum has been lost as government attention has focused on reform of the banking system and on credit default swaps and their regulation rather than on passive investment flows into and out of commodities or on algorithmic trading and its impact on volatility. Governments should have a concern about these financial flows and their multiple impacts for a variety of reasons. For example, last year's misapplied attention to passive investors, calling them speculators, was both populist and incorrect. The source of most commodity investments as investments comes not from speculators – whose position in providing liquidity should be fostered – but from pension funds allocating capital to commodities for retirees.

The G-7 and G-20 should do what they can individually and collectively to bring greater transparency to commodities markets. Oversight is a minimum requirement, against which there are considerable vested interests, especially by the large money-center banks that have been making markets for customers. We need to better understand who is involved in these flows, which requires extending oversight to currently non-regulated over-the-counter markets, which would establish a much more even playing field. Ways need to be found to encourage cooperation among governments to generate rules for electronic trading, which know no international political boundaries. And ways need to be examined to discourage excessive long or short positions and concentration of positions in commodities markets, just as they already exist in equity markets. Greater oversight alone with regulatory power provided to monitor markets and to limit positions when market conditions so warrant would assist in curbing both suspicions of and actual market manipulation and providing a path toward less price volatility.

6. Update the development and management of strategic stocks. It has been several decades since the IEA countries have individually or collectively re-examined their policies toward managing strategic stocks. In the meantime several approaches have been tried by countries that decided to build strategic stocks more recently, Korea in particular; new market mechanisms exist to extend the management of strategic stocks internationally; and new opportunities have emerged for forging international cooperation around them. In the Korean case, KNOC has been provided freedom to manage the country's strategic stockpile more intelligently and commercially than is the case in the US, Japan and some other IEA countries where governments own strategic crude oil or product stockpiles. They have storage capacity that can be leased for commercial fees to the private sector when the forward curve makes storage economical and they can exercise an option on some of that oil. Similarly they can sell or loan oil in backwarddated markets and either buy oil on a deferred basis at lower prices or obtain the commitment of buyers/lessors to return at a future date more oil than they have leased or bought. Sharing arrangements on existing storage can similarly be made available internationally through a formal system of options sold by storage surplus to storage deficit companies or governments, much as it is bilaterally within the EU through the European "ticket" system. Indeed, that very European mechanism should also be examined as the basis of internationally owned stocks deployed regionally for future security. For example, pools of oil can be set up and jointly owned in key coastal areas – such places abound globally, in South Africa, East Asia, in the Mediterranean and in the Atlantic Basin. Some countries can participate financially, others through the provision of material. And once established, third party countries, with no ownership in such inventories can be provided options – insurance if you will – to be converted into cash payment for crude or products if or as needed. Regional arrangements can provide opportunities for joint ownership by regional participants: for example an Asian-based stockpile could be jointly owned by importing countries such as the US, China, Japan, Korea, India, and by suppliers, such as Russia, Kuwait or Saudi Arabia. Smaller countries could buy options on the stored oil and both international cooperation and greater security could be assured.

A New Approach to US International Energy Policy

Adopt creative regional policies. US national security interests can be advanced by fostering regional energy integration, or by diversifying supply, or by reducing destructive competition for resources. US interests vary by region, as does the intensity of energy interests to our broader national interests. This has proved a lasting challenge to US foreign policy. Energy itself has not been seen as central enough to foreign policy to merit a top rank position at the foreign policy table, and when energy is the key tool to foster US interest, the government lacks the ability to coordinate policy across cabinet agencies or even within the diverse interests of the State Department. In the section below, we outline the regions critical to our national security interests and suggest ways that a fresh approach to international energy policy can advance core foreign policy interests and advance long term energy security.

Eurasia. The US has a critical interest in securing Russian cooperation on Iran, Iraq and Afghanistan, as well as ensuring Europe has diverse sources of energy supply, and that the Caspian states evolve as economically viable, politically autonomous, stable and pluralistic societies. These interests have been viewed by Russia, and at times by the US, as competing. They need not be. Russia, Azerbaijan, Kazakhstan and Turkmenistan all have interests in developing their energy resources for export to hard currency markets. All have interests in ensuring that energy transportation is not interrupted for commercial or political reasons. Most projections of energy demand for Europe, especially in a carbon constrained environment, show that there is adequate demand to provide comfortable revenue flows for all the region's producers at a fair return for their resources. Demand from China and potentially Afghanistan, India and Pakistan, provide the Caspian states with multiple potential markets for significantly higher levels of production.

Much of the Obama Administration's policies in Eurasia still echo the anti-Russian tone of the US government's initial Eurasian policies set in place in the aftermath of the collapse of the Soviet Union and all oriented toward the protection of the autonomy of the Caspian and South Caucasus countries. In today's low price environment, Moscow, partially in reaction to those policies, sees an opportunity to re-establish influence by granting generous credits to these former Soviet countries. But an opportunity now exists to set aside those suspicions and to look for solutions that are win-win-win for Russia, for the countries themselves, and for the US and other interested outside parties.

In this light we can see the outlines of a fresh approach to US policy in Eurasia. First, think regionally, by crafting a policy that welcomes rather than fears a major place for Russia. Second, offer a projection of regional demand that shows all players that there is room for all at a fair rate of return. Third, consider new rules of the road for energy transportation, perhaps by revising or replacing the Energy Charter Treaty, to assure shippers that transit countries will not interrupt supply, assure producers open access to pipelines, and require reciprocal access to the upstream by consuming countries if producing countries wish to purchase access to their systems of distribution of power generation.

The implicit bargain here is that countries like Russia will have rules that will promote efficient resolution of payment disputes with countries like Ukraine in exchange for their obligation not to cut off supply. It will welcome a Russian presence in Europe's power sector if Russia will open its resources to fair exploration and shipment. It will require that Russia tolerate multiple pipelines, and not resist alternatives to shipment through Russia, but with the assurance that there are adequate supplies (and transit fees) to provide long term security from that sector. A more compliant Russian attitude should free countries like Turkmenistan to develop their upstream resources and ship them to the highest bidder, without political interference from any quarter. A new bargain might also provide Russia a graceful excuse to welcome foreign capital back into its upstream sector, and reverse the decline in production growth that has resulted from its renationalization. Russia could see that a more traditional tax and royalty scheme can provide it the benefits of generous revenue from the energy sector without exercising monopolistic (and apparently unproductive) control.

This win-win approach might pay dividends by reducing Russian concerns about allowing Caspian states to serve as transshipment points for US military supply to the Afghan theater and also assure China that the US supports, rather than resists, delivery of Caspian energy resources to China.

Middle East. The US has multiple national security stakes in the Middle East: the stabilization of Iraq, rapprochement with Iran, peace in the Levant, the development of moderate Arab regimes, promoting development in fundamentalist Arab states, the conduct of sovereign wealth funds, and connected to most of these, reducing the tolerance and support for anti-America terrorism in the region. The region's leaders are confused by US rhetoric that alternates between calling for an end to energy imports from the region, to calls for increased production, to proposals that energy revenue be used to finance peace and development in the region.

A more nuanced US policy would find a more constructive tone, which recognizes both the utility of hydrocarbons for the medium term, the importance of the support of these states of investing in stable production, and the need for all of our economies to diversify and prepare for a less carbon intensive world. The US needs to have a view on what would happen to these nations, and regional stability, as long-term demand for hydrocarbons flattens and then declines. Energy can play a key role in reconciliation with Iran – as an incentive, a sanction, and as a product of rapprochement. As an incentive, allowing Iran oil swaps from the Caspian, removing objections to its sales of oil or gas to neighbors, and favorably viewing foreign investment in exploration, production and refining are all powerful incentives for Iran, providing important support to its economy. Bans of product imports and additional restrictions on investment in Iran could also inflict severe economic pain on the country. A full reconciliation could open Iran as a route for energy transportation, proving cost effective export routes for Caspian gas to Europe and South Asia. Adding Iran's production to the global mix, and freeing transportation routes across that nation could provide a dramatic improvement in the diversity of global supply and helpful balance to Russia's dominant market position in Europe.

Energy plays a critical role in fostering greater political reconciliation and long term stability in Iraq. The US should assist Iraqi lawmakers in brokering a sustainable power-sharing arrangement where regional oil companies are in charge of negotiating deals but the federal government has veto authority and the revenue is equitably shared among the provinces.

Energy will play a role in Afghanistan's long-term stability. The country will need gas for electric power. Turkmenistan could provide supply if it developed the resources to export it, and if it were assured of a hard currency market. An intergovernmental effort to secure a pipeline from Turkmenistan through Afghanistan to Pakistan and India could provide enough of a market at the end of the pipeline to justify some off take in Afghanistan. This pipeline has long been bruted, but was deemed impossible for security reasons. It could provide a strong foundation for regional integration as well as regional economic prosperity.

Africa. US interests in Africa lie in promoting the stability of existing democracies, controlling the spread of HIV/AIDS and malaria, reducing conflict, countering terrorism and helping the continent evolve to both political and economic self-sufficiency. As the credit crisis dries up private capital for African development, and with most of the continent's income dominated by commodity trade, the potential for expanding instability and more intense internal competition for resource rents are rising.

The crises in the Horn of Africa, the Democratic Republic of the Congo and Sudan take up most of the US diplomatic attention. The fate of the region's key producers is also important for reasons of conflict prevention as well as long term US energy security. Nigeria's Niger delta crisis has long been neglected by US policy makers. An implosion in Nigeria would destroy any hope of regional prosperity. Escalating violence in Nigeria has already led to the spread of violence to Equatorial Guinea and Cameroon as the insurgency increases in lethality and sophistication. Local fisheries are endangered by a lack of coastal security, or even an ability of host governments to see who is in their waters.

A refreshed US policy in Africa would focus on improving the capabilities of West Africa governments to conduct the basic business of government – managing finances, equipping coast guard and navy, training police and judiciary and supporting the rule of law. Attention should be paid to the new emerging producers as well as traditional suppliers. These changes would improve human rights, reduce conflict, and improve the investment climate. US support for Africa has been predominantly for health, not governance. The balance should change. Diplomatic attention must be paid as well. Countries from Nigeria to Equatorial Guinea to Gabon and Ghana care deeply about their image in the US. Positive diplomatic attention could support reform efforts.

Africa has witnessed intense competition for resources in the past decade. Europe, China and other countries have sought to curry favor with African governments with mineral or hydrocarbon reserves to gain access. Newly emerging international standards of environmental practices or revenue transparency have been increasingly sidelined as competitors seek favor by proposing access with “no strings attached.” In some cases, like Angola, or Congo Brazzaville, international efforts to promote transparency as a step to long stability suffer. In other cases, such as when China and Malaysia national champions, CNPC and PETRONAS, increased their energy investment in Sudan as western countries fled, the result has been the financing of more intense conflict with horrific human costs.

A more collaborative approach is possible. First, China and the US in particular have common interest in securing price stability, long-term access to resources, safety of their people and open competition for acreage. Our two countries should have a dialogue on this topic. Second, US reflexive criticism of China's style of development for Africa, offering turnkey infrastructure projects for access, should end. The jury is out on whether either model provides sustainable development for Africa, but demonizing China's style for competitive reasons is not constructive to broader US-China interests or to Africa's own development. Likewise efforts to improve governance in Africa should be on the agenda for US-EU discussion as well as

bilateral talks. A multi-stakeholder engagement in the Niger Delta would help bolster Nigeria's nascent efforts to address this issue as well.

Latin America. U.S interests in our own hemisphere are multiple: trade relations, immigration, cultural ties, control of crime and the human condition of our closet neighbors. Energy is a key source of revenue for Brazil, Mexico, Venezuela, Bolivia, Argentina, Colombia and Trinidad and Tobago (among others) and access to energy products and electricity is critically important to the Caribbean and Central America states. Hemispheric energy is important to the US as well – we import nearly half our energy from Canada and the Western Hemisphere. In recent years we saw high prices lead to nationalization efforts in Venezuela and Bolivia. Opposition to the use of foreign capital has long left Mexico's energy sector starved for capital and seen a dramatic decline in its production capacity.

This new price cycle provided an opportunity for the US and the hemisphere's producers to consider new collaborative approaches. Regional collaboration on electricity generation and transmission can reduce both costs and emissions growth. Venezuela and Bolivia, now unable to afford generous domestic programs and spending for investment in exploration and production, are rethinking their strategies. The challenge for all countries will be to find ways to depoliticize energy and that assure contracts are both fair and respected. To get to this more collaborative place, it must be acknowledged that more equitable bargains, which allow rents to be shared in high price environments while protecting expected levels of return on investment, must be struck to assure that agreements are sustainable in the long run. The US can use the convening power of the US government to encourage international oil companies to develop a unified position and reduce the risk of the beggar-thy-neighbor approach which has allowed host governments to play one company against the other.

The path to long-term energy security is through strong, respectful, and mutual bilateral relations overall. The countries of the hemisphere are focused on a social agenda – trade and immigration, and their impact on wages, jobs and the human condition. The US needs to engage the leaders of the hemisphere on this agenda, and also engage them at the sub regional level where interests vary significantly. With this kind of dialogue in place the US should restore the technical dialogue it has had with Venezuela and create a bilateral energy dialogue with Brazil.

Asia. US interests in Asia, from China and Japan, to India and the subcontinent, are increasingly focused on ensuring that the fast growing economies like China and India evolve into responsible international powers that conduct their affairs in harmony with their developed neighbors and the norms of the international community. The strategic dialogue began under the most recent Bush administration, the nuclear agreement with India in 2008, and Secretary Clinton's first foreign policy trip to Asia recognize their priority. China and India are also central to the climate change dialogue, as their emissions growth, left unchecked, could swamp OECD sector carbon reductions. Much has also been made of China and India's rapidly increasing demand for energy as their economies grow, particularly concern over their use of government loans and subsidies to finance acquisitions of oil, gas or minerals acreage, and their use of "package deals" to offer swaps of acreage for infrastructure or low cost loans.

Much of this debate has been hyperbolic and destructive. China's and India's growth is a positive development, long sought and much to be welcomed. Their equity ownership of oil and gas production, even in Africa where the debate has been most salient, is modest compared to their demand. Most of China's equity oil is traded in international markets in any event. China in particular has taken important steps, including increasing fuel efficiency standards, reforming retail prices, building strategic reserves and filling them when international prices are low, converting Beijing buses to natural gas and mandating new housing construction in China to use gas rather than coal for fuel.

The conflicts with China and India deal more with their departure from international standards of lending and transparency in their acquisitions, and more acutely their substantial and increasing investment in Sudan's energy sector, despite the impact of this investment initially on the North-South conflict, and now in Darfur as well as Burma.

Despite these tensions, we believe that there is a broad energy and environment dialogue which will align the interest of the US and Asian energy consuming nations in price stability, ensuring a free market in acreage, the safety of personnel operating overseas, diversity of energy supply, efficiency technology, building and appliance standards, government management of energy use, and next generation biofuels. A similar dialogue, launched under President Clinton's leadership and led by Vice President Gore with the Chinese Prime Minister, led to broad based and harmonious interactions on the public and private sector level.

We recommend that the US revive White House a cabinet level energy and environment binational commission with China and India, and launch a new initiative with APEC as well. These should be instituted at the Presidential visits to these two critical countries. The dialogue needs to be focused on what is most of concern to our partners – sustainable growth. The US should use that conversation, the role of

energy in providing growth, the ways to protect the environment in the process, and strategies for pursuing that in a harmonious way as an entry point to talk about international standards on investment, security of supply and access, and the stability of key suppliers in Africa, Latin America and other regions. The US should take a more modest tone when it comes to China's style of overseas investment. As noted earlier, China's approach is providing much needed infrastructure investment in Africa and elsewhere when host countries (and other foreign companies) are strapped for both cash and capacity. A less dismissive tone by the US could facilitate a more constructive conversation about the role of resisting corruption and creating a level playing field in ensuring the long-term stability of energy suppliers.

Promote good governance and transparency. The US has had long standing interests in fighting corruption and ensuring transparency in the conduct of business overseas. The Foreign Corrupt Practices Act, support for the OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions, and nascent support for the Extractive Industries Transparency Initiative (EITI), are examples of the depth to which these goals are embedded in US foreign policy. These goals help promote more stable governments, reduce rent seeking, facilitate a level playing field for American businesses, and support human conditions in the developing world by trying to ensure that public funds (host government or foreign assistance) go to economic development and not for private gain.

In the past eight years we have learned a good deal about how to promote good governance and transparency. In our view, we have learned that there must be political support for reform in a country to have a serious prospect at change. There are virtually no examples of forcing transparency in the extractive sector on an unwilling government by civil society, companies or foreign government. We also believe that where reformers are present, it tends to be at the highest levels of government where they can demand accountability for the lower levels.

All of this highlights the need for a new approach to dealing with issues of governance, accountability and transparency. While it has been an important stepping-stone, and should be continue to be supported, it is time to move US policy beyond EITI.

- 1. One area of emphasis should be on building up the capacities of finance ministries to monitor revenue flows, and of energy and interior ministries to regulate and manage*** their extractive industry sectors. Helping governments that are willing to do better to learn how to strike a more sustainable deal, adopt transparent methods of marketing and managing their resources, will demonstrate to them how transparency actually translates into higher levels of revenue for host governments.
- 2. Support should be given directly to civil society groups,*** from media to advocates, to educate them in the sector they wish to reform and ways to participate constructively in a democratic process where one exists.
- 3. The US should place emphasis on accountability in public expenditure*** in those nations where it provides generous levels of foreign assistance. The US standard could be as simple as asking the government to commit to an IMF public expenditure review, which looks at the integrity of public spending, rather than asking to do this itself.
- 4. The US should give these issues a bureaucratic home.*** At this time, no office in the Department of State has dedicated responsibility for the promotion of good governance and transparency in energy-producing countries. The Democracy and Human Rights Bureau owns some policies, such as the voluntary principles on energy and security. The Economics and Business Bureau has at times staffed the EITI at a junior level but so has the Policy Planning Office. In the spirit of integrating economic and governance issues rather than stove-piping them, this responsibility could be placed in a single bureau.
- 5. Adequate funding should be allotted to issues of governance and transparency.*** Most US aid in Africa, by example, is for health not governance. There should be adequate funds allotted for technical assistance of the kind described above, and the priority should be mandated from Washington, not left to the discretion of individual USAID country managers.

Organize for change. The US foreign policy architecture is not designed to advance a strategic international energy policy. The US has had ad hoc and often ineffective approaches to energy security in the Caspian and the Gulf of Guinea, European energy dependence, and Arctic-hemispheric energy integration. To be effective, and to manage the kinds of approaches described above, these policies require the US interlocutor to be of a rank where they will have access to senior ministers in the foreign, energy, and environment ministries abroad, and in many cases heads of state and government. The US interlocutor must also have the bureaucratic power to coordinate policy among the diverse bilateral and functional actors in the US system.

The Obama administration has taken a major step forward in fostering policy coordination in the domestic arena by creating a White House energy security council and appointing a director who has the same rank

as the national security adviser. But so far the leadership at the White House and the State Department has been focused on managing domestic energy demand policies and international climate policy, but not international issues of energy supply. These lacunae could be filled by increasing the profile of the Under Secretary of State for Economic, Energy and Business Affairs on energy issues, creating an Ambassador-at-Large for International Energy and by creating an international energy directorate at the White House, at rank of deputy national security adviser. A person at this rank could help foster bi-lateral energy and environment initiatives with China, India, and other emerging economies (the sources of the largest increases in energy demand over the next two decades), lead multi-sector initiatives with energy implications, such as addressing conflict in the Niger Delta, and provide consistent, intensive and dedicated White House leadership on other international energy issues.

The time is now. The US must act quickly to enhance our energy security and our ability to absorb future price shocks. We must improve collective action among consumers, increase transparency in both market data and host country financing, encourage more open access to transmission and transportation networks and better position US foreign policy by more closely integrating energy and national security concerns.

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