

7-1-2007

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Recommended Citation

Larson, Alan (2007) "Oil. The Geopolitics of Oil and Natural Gas," *New England Journal of Public Policy*. Vol. 21: Iss. 2, Article 18.

Available at: <https://scholarworks.umb.edu/nejpp/vol21/iss2/18>

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The Geopolitics of Oil and Natural Gas

Alan Larson

Ensuring the reliability of global energy supplies will call for policies that both encourage the use of newer, cleaner energy technologies and address the political challenges posed by the world's growing demand for oil and natural gas. U.S. policy seeks to encourage expansion and diversification of world energy supplies and to promote the transparency and democratic institutions that help energy-producing countries make the most productive use of their resources.

Energy is the vital ingredient in the world economy. While we are working hard on energy efficiency and investing to develop new energy technologies, oil and natural gas will remain critical for many years to come. Economic development around the world means global demand for oil and gas will continue growing in the near term. Most significantly, China's rapid growth and increase in overall energy demand continue to affect energy markets. Some analysts estimate that China could account for as much as one-third of the world's marginal increase in oil demand in the coming years.

As a result, the world must find and develop more reliable supplies of oil and gas at prices that permit sustained economic growth. Unfortunately, it is almost an axiom in the petroleum business that oil and gas are most often found in countries with challenging political regimes or difficult physical geography.

Several realities shape our thinking about energy security and how we should build reliability into our energy supplies:

- Two-thirds of the world's known oil reserves are in the Middle East.
- Imports supply roughly half of the oil and 15 percent of natural gas consumed by the United States, and an even greater share of the needs of some of the United State's most important allies and economic partners.

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- Oil-supply shocks in any region of the world will have an impact on the U.S. economy through the instantaneous operation of international oil markets.

Reliability through Diversification

Energy investments are costly and risky, requiring long-term commitments. Recognizing this reality, U.S. energy policy seeks to encourage expansion and diversification of energy supplies. A number of regions are attracting increasing interest from energy companies in the United States and elsewhere. We see interesting prospects for expanded oil and gas production in the Caspian region, Russia, West Africa, and North and South America, as well as the promise of increased oil and gas production in the Middle East. In each of these regions, our policy aims to support private sector-led development of energy resources by reducing the political uncertainty that otherwise might hinder needed investment.

Russia and the Caspian Basin

Russia already is an energy superpower. To achieve its full potential, Russia needs to strengthen corporate governance and the legal/regulatory framework for business, improve its foreign investment climate, allow competition in the transportation system, open up the gas and oil companies Gazprom and Transneft to reform and competition, improve its technological capabilities, and move domestic energy prices to world levels.

The Caspian Basin has tremendous potential, offering the possibility of production increases from 1.6 million barrels/day (b/d) in 2001 to 5.0 million b/d in 2010. The key issues in Caspian energy development at the moment are to: 1) complete the second pillar of the East-West Energy Corridor by developing the South Caucasus natural gas pipeline; 2) improve the investment climate throughout the region; and 3) bring Kazakhstani oil into the East-West corridor.

Multiple pipelines that economically bring Caspian resources to the world market strengthen the sovereignty and economic viability of the new nation states in the region. U.S. efforts in the Caspian are intended to complement — not detract from — U.S. support for Russia's efforts to develop its energy export potential.

Africa

Africa is playing an increasingly important role as an energy supplier to U.S. and global markets. In 2003, both Nigeria and Angola were among the top ten suppliers of oil to the United States. Oil production generates substantial revenue in countries such as Nigeria, Angola, Gabon, Equatorial Guinea, Republic of Congo, Chad, and Cameroon. São Tomé and

Mauritania also may become oil suppliers in the coming years. Foreign direct investment is needed to develop African energy resources as most new fields are in deepwater offshore environments that require advanced capital-intensive facilities for development. Growing oil and gas production could be a powerful engine for national economic development in these countries. However, the Niger Delta experience of 2002, in which protesters stormed oil facilities and caused their temporary shutdown, shows that oil can also be a disruptive force if a country's oil revenues are not managed in a fair and transparent manner. Nigeria has learned from its experience in the Niger Delta and is setting an example on transparency and economic reform enabled by oil revenues that the United States hopes other countries in Africa will follow.

North America

The most important and reliable sources of energy for the United States are its neighbors and we are strengthening our energy cooperation with Canada and Mexico. Senior energy experts from Canada, Mexico, and the United States recently released a North American *Energy Picture* report that, for the first time, jointly measures energy stocks, trading balances, and energy flows. What often goes unrecognized is that North American energy trade is a two-way street. Mexico is becoming an important source of U.S. oil imports. At the same time, the United States is a net natural gas exporter to Mexico, and U.S. refineries supply over 15 percent of Mexico's refined petroleum products.

The reliability of North American energy trade is enhanced by geographic proximity. More important than geography, however, are the rule of law and predictable investment conditions created by the North American Free Trade Agreement, integrated pipeline networks, and long-term reliable supply relationships. We are continually working to enhance this framework of rule of law and predictable investment conditions in North America even as we seek to build similar frameworks in other regions.

Venezuela

Venezuela and the United States have enjoyed strong historical energy ties. Venezuelan oil policy, until recently, has been built upon a reputation of reliability. Unfortunately, actions and statements by parties from all sides over the last 18 months have called into question the priority Venezuelans place on their reputation as a reliable supplier. The United States will continue to work to help Venezuelans resolve their political differences. But until a constitutional, democratic, peaceful, and electoral solution is achieved, and the level of rhetoric lowered, world energy markets simply cannot view Venezuela with the same certainty that they once did. When

the Venezuelan parties show a commitment to reconciliation, they will find a willing and ready partner in the United States.

Saudi Arabia and the Gulf Producers

The Middle East holds some two-thirds of proven world oil reserves. The size of its reserves, combined with its low production cost, guarantees that the Middle East will continue to play a pivotal role in the world energy market. Saudi Arabia plays a key role in global oil markets as the world's largest oil exporter. Moreover, Saudi Arabia supports international energy security by maintaining considerable excess production capacity that can be brought on line quickly in the event of a serious supply disruption anywhere in the world.

Diversifying global oil supplies should not be interpreted as diversifying “away” from Saudi Arabia or other Gulf producers. Gulf producers will continue to have an indispensable role in the world market, and the United States encourages them to increase foreign investment and steadily expand supplies. What we seek is better balance and a more flexible, resilient oil market that responds to price signals.

In this regard, Gulf producers could reap greater benefits by opening their economies to more private investment so that oil and gas capacity could grow and energy supplies could respond more fully to shifts in demand. Investment in natural gas is one sector where this process is beginning. Once only for local or regional use or wasted through harmful flaring, natural gas in the form of liquefied natural gas (LNG) has become an increasingly globally traded energy source for key markets. Qatar is working with major international energy companies to become a leading LNG exporter.

In the United Arab Emirates, the successful Taweelah power and water privatization project is another example of the dynamic role foreign investment can play in the energy sector. The United States supports these positive private investment initiatives because they expand and diversify its energy sources, provide opportunities for U.S. companies, and foster economic growth in energy-producing nations.

Promoting Transparency and a Good Investment Climate

Promoting transparency and good governance is a key part of the U.S. strategy of encouraging diversification. Oil and gas projects are controversial in many developing countries because revenue flows are hidden, or diverted, and average citizens feel they receive no benefit from their country's natural wealth. The United States wants oil-producing countries to invest energy revenue in solid and sustainable economic development for their populations, not only because it is the right thing to do, but also be-

cause it builds political support for the further development of energy projects. Democratic processes and the development of responsive governing institutions promote political and economic stability, the use of mineral wealth for poverty reduction and economic development, and the reduction of oil-related conflicts in energy-producing countries around the world.

A comprehensive approach to transparency is particularly important. At the June 2003 Group of Eight (G-8) Summit, President Bush and the other leaders endorsed a comprehensive action plan on *Fighting Corruption and Improving Transparency*. The core of this approach is forging a partnership to give willing host countries technical and political support to strengthen domestic institutions and enhance transparency and accountability. We want to focus specifically on budget, procurement, and concession-letting transparency, including G-8 support for technical needs identified by experts.

In addition to support for developing country action plans in these areas, the G-8 leaders committed to:

- denying safe haven to corrupt leaders and their assets by, among other things, denying visas to corrupt officials
- pushing for accelerated implementation of the Organization for Economic Cooperation and Development's Anti-Bribery Convention
- encouraging the World Bank and other international financial institutions to insist on greater transparency in the use of funds by borrowing countries

G-8 countries are supporting voluntary compacts among governments, the companies operating in those countries, and civil society to improve transparency in public financial management and accountability. These compacts outline both the political commitment of the G-8 and host governments to achieve specific mutually agreed transparency objectives, with assistance from the G-8 and international financial institutions, and a specific concrete action plan to achieve those goals.

Conclusion

In the long run we need new technologies such as hydrogen and carbon sequestration that can fuel our economy while increasing energy security and minimizing the environmental impact of energy use. In the interim, our international energy policy must address the familiar challenges posed by a hydrocarbon-based economy where oil reserves are concentrated in various challenging regions of the world. Transparency and good governance are increasingly important to sustaining international investments in energy development in regions of opportunity for energy production. The United States will continue to engage intensively with energy partners all over the world to diversify supplies, improve investment opportunities, and assure that market forces work as transparently and efficiently as possible.