The Global Race for Oil and Gas:

Power Politics and Principles in Asia

Ingolf Kiesow

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Key Abbreviations

ASPOG	Association for Studies of Peak Oil and Gas Production
ECT	Energy Charter Treaty
IEA	International Energy Agency
IOCs	International Oil Companies
NOCs	National Oil Companies
OPEC	Organization of the Petroleum Exporting Countries
SCO	Shanghai Cooperation Organization
SLOCS	Sea Lanes of Communication
STEM	Swedish Energy Agency

Executive Summary

According to a vocal group of international scientists, global oil and gas production would seem to be in decline rather than on the increase, thus creating a world-wide gap between increasing demand and declining power production. This is not yet a generally accepted truth, but the real issue is that politicians around the world display a tendency toward subscribing to Peak Production theory and acting accordingly. Sometimes leaders of these states try to grab as much oil and gas as possible with little consideration of the consequences for other states. It is happening in many subtle ways and mostly not openly, but some tendencies can be observed to be of a general nature and they are likely to create problems in the future. The competition between consumer states over energy raw materials has already resulted in a race for oil and gas in Central Asia and Siberia.

The academic world now has a task to alert politicians and public opinion to the growing need for geostrategic thinking, whether we like it or not. However, the alternative is decidedly unattractive: it is likely that China and India, ultimately even the U.S., EU, and Japan, will begin to "play hard-ball" in the race for energy raw materials.

Europe has experienced relatively calm development in the field of energy, at least when compared with other regions. There are hopes that the spirit expressed in the Energy Charter Treaty (ECT) can be a guideline for an international policy of cooperation, the creation of which seems to be necessary. The aim of the Charter is to strengthen the rule of law on energy issues, by creating a level field of rules to be observed by all participating governments, thereby mitigating risks associated with energy-related investments and trade. China and India, with close to forty per cent of the world's population, are already being confronted with the following problems:

- Is owning oil and gas when loaded a wise policy?

- Does it make sense to spend enormous sums to avoid transportation risks?
- Is it realistic to try to establish partnerships with producers of an exclusive character – and how to react when energy supply becomes intertwined with strategic game playing?
- Should Developing Countries be given a special handicap in the race for energy raw materials?

It is clear that one of the potentially most dangerous issues in the world, namely North Korea's nuclear ambitions, not only has its roots in North Korea's need for energy and difficulties in getting access to energy at affordable costs, but also that a solution has to be found to that problem. To do so, however, will require that an energy cooperation mechanism is agreed upon, or at least that principles for trade with energy can be established and codified.

I. Theories about Price and Availability

This paper deals with energy security as an international problem. The main focus is on the geostrategic consequences of the rapid price increase for oil during the first years of this millennium, from a level of US$24-28/barrel to nearly US$150/barrel, followed by a decline to levels somewhat above US$100 /barrel. The impact has not been sudden but it has been enormous, and "resource nationalism" has again become a common phenomenon. Examining how widespread it is and if there is a need for counter-measures is the subject of this paper.

Such upheavals like the recent oil price fluctuations are naturally a cause for speculation. Politicians and media turn to scientists, and scientists of different kinds offer widely differing conclusions. Some subscribe to "zero sum thinking" while others go so far as to say that the world has no need to worry about the situation and that the oil business can go on as usual. The question is not unimportant, however, as to whether it is right to carry on a national resource policy dictated by nationalism – believing oneself to be involved in a zero sum game – or to favor a free market. Some of the theories of the scientists shall be outlined as a background to the subject.

The *Oxford Encyclopedic English Dictionary* (1991) gives several definitions of "science." The first one is "a branch of knowledge conducted on principles involving the systematized observation of and experiment with phenomena, esp. concerned with the material and functions of the physical universe (see also natural science)."

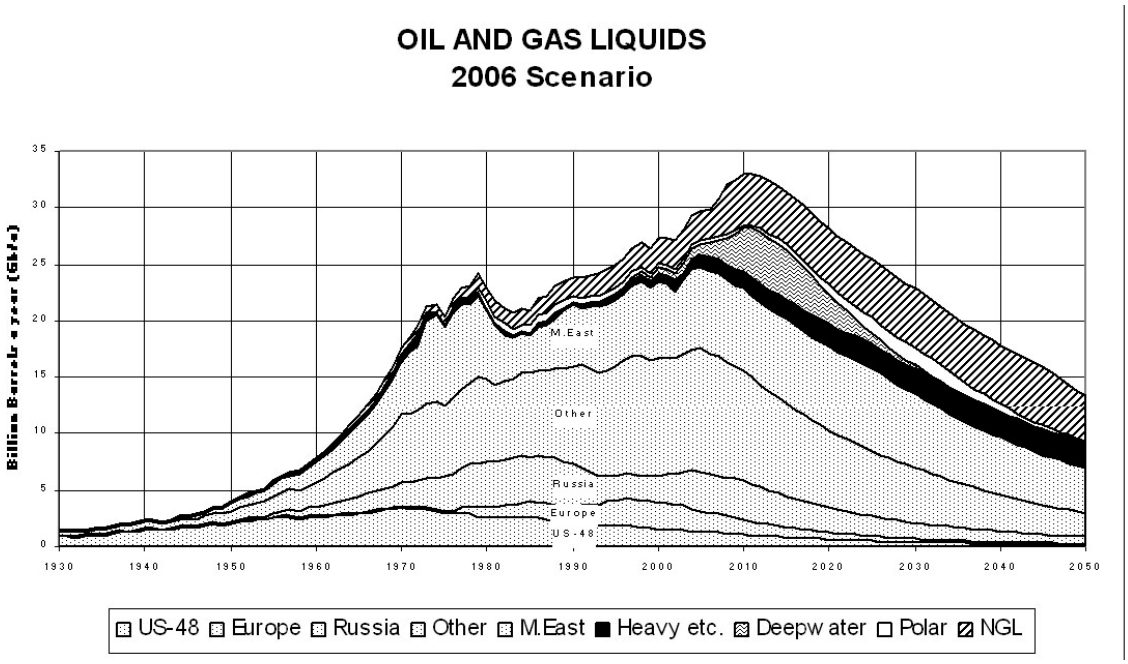
A number of natural scientists – but not a majority – have begun warning about "Peak Production."

Peak Production Theory

The following table has been created by Professor Kjell Aleklett, University of Uppsala, who chairs the Association for Studies of Peak Oil and Gas

Production (ASPOG). ASPOG is an association of specialists focusing on different aspects of oil and gas production, including geologists, physicists, engineers, and economists, who are concerned with the present trend of continued increases in oil and gas consumption. They consider it well enough established where oil and natural gas can have been formed during the earth's history and that we today have enough knowledge about where it could happen. All these areas have likely been investigated already and therefore oil is not likely to be found in other areas. They also consider it established as a matter of fact that current levels of production have reached the highest levels that all the world's oil fields are likely to yield. Indeed, they actually tend to argue that we have already passed the "Peak Production" level and that instead of counting on continuously rising consumption levels, we will have to reduce them because of slowing production.

Fig. 1. Production of oil and gas liquids to year 2006 and production scenarios



The regular oil is divided into the fractions US-48, Europe, Russia, Middle East, and Other is the rest of the world.

One set of facts seems to support the standpoint of the "alarmists." Six oil companies – Exxon, Mobil, BP, Shell, Chevron, and Texaco – together account for 15 per cent of the world's energy production. The annual added capacity of their collective purchasing of new oil fields as compared to their

combined sales of oil was 153 per cent in 1997. In 2000 that figure had decreased to 125 per cent, and in 2004 it was just 70 per cent.

Objections from Other Natural Scientists

Even if an increasing number of natural scientists accept Peak Production theory, it does not seem that on the global level they represent the dominant opinion. Representatives of the "Establishment" (i.e. traditional branch expertise) have basically the following objection: unconventional resources have not been included in the calculations of ASPOG. Already now the share of unconventional oil in production exceeds 5 per cent globally, and Cambridge Energy Research Associates (CERA) has calculated that in 2010 the figure could already be as high as 35 per cent. The International Energy Agency (IEA) has made the following definition of "unconventional oil" and "conventional oil":

> There is no universally agreed definition of what is meant by conventional oil or gas, as opposed to non-conventional hydrocarbons. Roughly speaking, any source of hydrocarbons that requires production technologies significantly different from the mainstream in currently exploited reservoirs is described as non-conventional.[1]

In this context, future production of synthetic oils is considered to be only limited, mostly for environmental reasons: they require a great deal of energy to be produced.

Environmental factors also represent a problem for the production of oil from tar sand and bitumen (but to a lesser extent than for synthetic oil.) This kind of unconventional oil is available in very large quantities, actually as large as the known reserves of conventional oil, according to IEA calculations. With present-day techniques, the most expensive way of extracting oil is from bitumen. It can only be done at a cost of around US$25 to US$70/Barrel. In spite of this, considerable investments are already being made in this kind of production.

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[1] International Energy Agency & OECD, *Resources to Reserves* (Paris: International Energy Agency & OECD, 2005), p. 26, available at: http://www.iea.org/textbase/hppdf/free/2005/oil_gas.pdf.

> We see no evidence to suggest a peak before 2020, nor do we see a transparent and technically sound analysis from another source that justifies belief in an imminent peak, CERA Senior Consultant and Director of Global Oil and Gas Resources Robert Esser testified before a House Energy and Air Quality Subcommittee hearing on Understanding the Peak Oil Theory. [This was in 2005.]
>
> CERA projects that world oil production capacity – including crude oil, condensate, natural gasliquids (NGLs), oil sands, gas-to-liquids (GTL), and other sources – has the potential to rise from 87 million barrels per day (mbd) in 2005 to as much as 108 mbd by 2015, with further growth in capacity continuing after that point [....]
>
> A detailed new audit of our own analysis and the enormous scale of reserve upgrades in existing fields, confirmed by the most extensive and complete databases on field production – the proprietary databases of IHS, of which CERA is now part – contradicts those who believe that peak oil is imminent, Esser testified.
>
> Between 2005 and 2010, production capacity expansion will be split between OPEC and non-OPEC countries, according to the CERA analysis; over the coming ten years, OPEC countries will produce a net gain of 12.2 mbd, almost 60% of the total expected capacity increase, with non-OPEC capacity rising 8.2 mbd. Regionally, the United States and North Sea capacity declines, while Canada, West and North Africa, Latin America, the Caspian and Middle East continue to increase. After 2010, increases in capacity will shift more to OPEC countries.[2]

CERA expressed the opinion that, accounting for investment decisions that have already been taken, it is likely that capacity to extract oil will develop at the same speed as demand during the next 10 to 15 years.

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[2] IHS, "World Oil Production Capacity To Increase up to 25% by 2015, No Peak Seen for Decades, CERA Tells House Committee: Field-by-Field Analysis Indicates Over One-Third of Capacity from Non-Traditional Liquids in Ten Years," available at: http://energy.ihs.com/News/Press-Releases/2005/pr_120805_essr.htm

One observation has to be made here. Since the International Oil Companies (IOCs) – as we have seen above – have declining, or stagnant, amounts of resources available in reserves, they are likely to get a smaller share of the total world production during the next 10 to 15 years. National Oil Companies (NOCs) are likely to account for the remaining part, due to their better access to the owners of the remaining new fields, who typically are governments. That means that the "free market" will have a shrinking share of the total market.

Economists

Another definition of "science" according to *The Oxford Encyclopedic English Dictionary* is "systematic and formulated knowledge, esp. of a specified type or on a specific subject." Economic science is one example, and there are several economic theories which claim to be relevant in connection with Peak Production theory.

An often heard objection to Peak Production theory is that there will always be oil left in the ground, since extraction will only take place as long as it is profitable. The limit for profitability is the level where demand no longer exceeds available supply. At that point there will be no more investments in oil extraction equipment or new oil fields. Nobody will buy the last drops of oil, since the costs of extraction will be unacceptable. That is, of course, more a play with words than a valid objection to the Peak Production theory, but it points to the importance of price elasticity and the relevance of investments for the price and availability of oil.

The Swedish Energy Agency (STEM) has made a critical analysis in a report entitled "Finality of oil – a moving target."[3] According to STEM, the oil industry is cyclical as all other types of industry. Capital costs represent a very high share of the total cost. Capacity accumulation is created in leaps. When a finding is made, extraction can continue for several years. Accumulation of reserves consequently occurs at intervals as well, but it is also concentrated in periods of favorable trends, when the existing resource base and the extraction capacity are considered insufficient.

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[3] *Oljans ändlighet: Ett rörligt mål! En del av Energimyndighetens omvärldsanalys* [The limits of oil: a moveable goal! A part of STEM's monitoring of the international environment] ER 2006: 1 (Stockholm: Statens energimyndighet, 2006).

Typically the shift between cycles is characterized by a strong but peaking economic trend, which turns into recession. At the end of that period, the capacity for meeting the demand from the market is insufficient. Prices rise at the same time as investments in new reserves and extraction capacity increase. When the economic trend changes, investments have already resulted in new capacity. This creates larger reserves and a greater capacity than demanded by the market, which, in turn, leads to excess supply and falling prices, at the same time as investments in finding new oil and/or increasing capacity in existing equipment is held back. Soon, however, this situation with lower prices leads to another growth in demand. Prices rise at the same time as investments remain at a low level. At the end of the oil cycle, a period with very strong economic growth and strong demand for oil occurs. The previous excess capacity disappears and the reserves begin to decrease. This is when the oil companies again begin to invest in new oil and capacity for extraction; but this takes several years and, meanwhile, the gap widens between demand and supply and prices can rise very high.

It should be added that STEM made the prediction that in 2008 there could occur an excess capacity of about 10 per cent. "It is after all reasonable to expect that the present oil cycle will turn into a new cycle during the period 2008 to 2010, or shortly after that, with sharply falling prices."[4] On September 10, 2008, the Organization of the Petroleum Exporting Countries (OPEC) decided to lower its production level by 520,000 barrels per day in order to maintain the falling oil price level above the 100-dollar mark. The reason was that the oil price had fallen from US$147/barrel in June 2008 to levels a little below US$100.[5] Marian Radetzki, a prominent Swedish economist who is a strong opponent to the Peak Production theory, told the press that, in his opinion, already a cost level of US$40 per barrel could make it profitable to invest in new oil fields. There are very many such fields available for purchase. And an oil price hovering over US$100 per barrel means that it is also very likely that this is going to happen. That, according to his prediction, would also lead to sharply falling prices in the not so distant future.[6]

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[4] Ibid., p. 77.
[5] "Opec sänker oljeproduktionen [OPEC lowers oil production]," *Dagens Industri*, September 10, 2008, available at: http://di.se/Avdelningar/ArtikelUtskrift.aspx?ArticleId=2008\09\10\300015&tye=art.
[6] "Oljan kommer att falla i pris," *Svenska Dagbladet*, September 2, 2008.

According to this theory, the world is witnessing the beginning of a new oil cycle from September 2008.

Environmental Considerations

Professor Radetzki added that "if we want to diminish the use of oil and find alternatives then we must do it before the prices start falling again."This is a reminder of another dimension of the situation: the environmental dilemma. The car industry, already during the first years of this millennium, started to seriously attempt to use forms of energy other than combustion engines running on petrol. In 2008 battery driven cars with an operational range of up to 400 kilometers were introduced, and all car manufacturers have been trying to convince their customers that their new models are consuming less petrol than their competitors.

Moreover, further steps are being taken in certain countries, for example in China where the Ministry of Finance has been researching the feasibility of taxing on the environment and is preparing to put a fuel tax in place to improve the pollution problems. The target is that during the "11th five year plan" the energy consumption of GDP per unit should decline by about 20 per cent. The Ministry also asked "all levels of reform, industry, finance, tax, quality check and other departments to take efforts in leading and framing energy-saving policy by comprehensively using price, finance, tax, market access, government procurement, credit loan and other economic policies."

In Russia, during 2008, the government has planned "to cut its use of oil and gas in economic development by 2020, by introducing energy-saving measures," and "expected that the Russian economy's energy intensity will drop by 30-45% in 2020."[7]

Similar efforts in other countries add to the weight of a global effort to diminish the consumption of oil for environmental reasons. This may, of course, have a moderating effect upon investments by the oil industry. Supply will be lower and the price level will be higher. In theory this also means that supply will be less finite, since more oil will be left under the earth's surface.

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[7] "Russian economy to see lower dependency on oil and gas by 2020," *Alexander's Gas & Oil Connections,* Vol. 13, Issue #16 – Thursday, September 4, 2008, available at: http://www.gasandoil.com/goc/news/ntr83664.htm.

Long-Term Producer Ambitions Can Keep Production Down

Within the oil-producing Arab world, there has been an ongoing debate since oil became an important factor for the local economy. Should maximum export income now be the highest priority, or should it rather be to obtain maximum long-term value for all oil which can be extracted from the ground within the borders of the country? In Kuwait, the Emir decided very early on to establish an oil fund for future generations, and production has been kept below maximum capacity at the same time as production has systematically been shifted to higher value products, such as those from the petrochemical industry. In other words, Kuwait has made an effort to obtain value from its oil products for as long a time as possible. This policy leads to a higher price for the consumer but also for a longer life of the resources, which actually can be of advantage just as much for the consumer as for the producer.

This problem is, furthermore, of great importance. In a study by John V. Mitchell and Professor Paul Stevens for Chatham House Royal Institute of International Affairs, the authors conclude that:

> Countries vary greatly in their dependence on hydrocarbon exports. They differ also in their ability to replace oil tax revenues and foreign exchange earnings by diversifying their economies in future [While these groups are facing the challenges of depletion with varying levels of urgency, the report concludes that] no country whose economy now depends on oil and gas exports can escape the eventual transition to lower dependence on hydrocarbons, which will involve a combination of

- Domestic energy policy to restrain the growth of consumption and encourage the development of other fuels;
- More rapid growth of non-hydrocarbon sectors to pay taxes and generate exports (or reduce imports);
- Lower targets for economic growth.
- The challenge exists even for Saudi Arabia. The country could cease to export in thirty years' time, on the basis of its planned capacity of 12.5

> million barrels per day of crude oil production, if consumption grows on a 'business-as-usual' path.[8]

Saudi Arabia maintains that it is able to pump 12.5 million barrels per day for as long as the markets need, once new capacity has been installed in 2009. This claim has been disputed by rumors about a (confidential) field-by-field breakdown from 2009 to 2013. According to this source, production will not reach more than around only 12 million barrels per day – as late as in 2010 – and then only for a short period, after which it will have to be scaled down to around 10.4 million barrels per day. There have been many contradictory statements by Saudi officials and, on the whole, business-as-usual does not seem to be entirely the order of the day.

The question remains, therefore, whether there are real "depletion problems" for Saudi Arabia or if maybe "only" an insufficient investment-rate during the last couple of years is the real reason behind some of the apparent problems hindering production increases in Saudi Arabia and some other oil producing countries in the Middle East. It may obviously also be explained by pressures from influential quarters in Saudi Arabia to make the policy of the oil producing country concerned more long-term oriented and aimed at getting the best value out of the oil resources available. It is easy to understand why statements tend to be cryptic, when opposing forces are at work, as can be seen in the Middle East and Russia, for instance.

Limitations of "Science"

In this context, it is appropriate to remind of one truth that often tends to be forgotten regarding scientific models: they can be wonderful instruments to understand complex aspects of, for example, economic life, but they only work as long as the same variables are being used in the formulas and they only tell us something useful as long as everything else remains constant. In real life, everything is changing constantly and efforts to explain the functioning of markets have to take into consideration a great many variables that are not of an "economic" or "physical" nature and not possible to

[8] John V. Mitchell and Paul Stevens, *Ending Dependence: Hard Choices for Oil-exporting States*, Chatham House Report (July 2008); available at: http://www.chathamhouse.org.uk/files/11844_0708oildependence.pdf.

simplify into mathematic formulas. Moreover, very many economic chains of events take place at the same time and interact with one other.

This reminder is needed to underline another important fact. A certain amount of humility is required, even from scientists, when trying to understand trends in global events. Several fields of "science" are applicable simultaneously and predictions are rarely reliable, especially those concerning the future.

Neither Natural Science nor Economic Science can give us instruments that make it possible to describe in an exhaustive way what is happening to our need for energy. The present dramatic events on the global financial markets tell us that we have to use all instruments available if we shall have even moderate success in preparing for an uncertain future. There are even voices who ask if there is a possibility that the pillars of world oil demand growth will be undercut.[9] We need "an organized body of knowledge" on the subject which includes as many aspects as possible.

It certainly seems that we will have to live with a supply of energy that is less easily accessible and will cost more than we are used to; but we know little about the psychological and political consequences that this will bring about. The problem is that it remains a matter of great importance.

"Science as an Organized Body of Knowledge on a Subject"; Energy and the Study of Geopolitics

The Oxford Dictionary has a third definition of "science," namely "an organized body of knowledge on a subject." This definition seems to be best suited for describing the knowledge required in trying to understand the geopolitical consequences of the very strong fluctuations in the price of oil and also the resulting fluctuation of the price on the emerging spot market for natural gas, which tends to follow the trend in the oil price. A psychological climate that can be described as "resource nationalism" seems to be spreading and causing governments to act in the pursuit of "politics as determined by its geographical features," i.e. whether they are importers or

[9] "What Could Bring Oil Prices Below $100?" *Cera News*, September 7, 2008, available at: http://www.cera.com/aspx/cda/public1/news/articles/newsArticle Details.aspx?CID=9 (accessed September 16, 2008).

exporters of oil and gas. This will be the subject of the following discourse, but it should be observed that so far there does not seem to be any reason to believe in a predetermined "end of oil" occurring in the near future.

Oil and gas will have to be consumed in smaller quantities for a number of reasons, but it is still up to the governments of the world whether this situation will lead to a mindless race for oil and gas, causing conflicts and economic distress in other countries, or a balanced and coordinated change of consumption patterns and politics to make the transition as smooth as possible. In other words, there is no room for panic but a strong need for constructive and cautious thinking before taking concrete actions.

There is a problem for the "Western" countries – in this context meaning the U.S., the European Union, Japan, the Republic of Korea, and a few other industrialized countries with little or no oil: namely that the "free market" for oil and gas is shrinking. As NOCs begin to dominate the trade with new resources, the traditionally privately owned IOCs find it increasingly problematic to gain access to new fields. In a longer term perspective, this will inevitably lead to higher prices. This adds to the problems already described and which have been behind the price increases during the first years of the new millennium. Since it will have so strong an impact on the societies of the Western world, it seems inevitable that governments will have to become more active – and that can mean international competition of a kind that tends to create conflicts.

It would, however, be wrong to conclude that this is only a problem for the richest countries. The tendency to encourage and support the NOCs in their use of all available means to get access to new fields is much stronger in the emerging economies such as China and India. They feel that they are lacking influence over, and tend to be disregarded by, the IOCs, which traditionally have their head offices in the rich countries, and second that it is a patriotic obligation to help their NOCs in the competition with the IOCs as well as in the competition with NOCs from other countries.

Nothing Can Substitute Oil in the Transport Sector

There is a special dimension that tends to reinforce the patriotic rhetoric that is often heard in connection with debates about the need for "secure oil

supply." No other form of energy can be transported as easily and has such a high energy value per unit as oil. It is, for instance, not possible to fly an airplane on coal or electric batteries; and even the car industry finds it excruciatingly difficult to find acceptable alternatives for petrol.

Since mobility is vital for modern war fighting capability, differences in efficiency of transport means can be of decisive importance in fighting a war. This has been true ever since coal became a necessity for steam-ships, and finding bunker harbors for the navies of the empires during the 19th century led them to colonize places in the Gulf that were otherwise of no special significance.

As long as it is not possible to use alternative forms of energy in the transport sector, the needs of the transport sector and the military will make the demand for oil a great deal less elastic than demand for coal, nuclear power or hydroelectric power. The military aspect makes that situation potentially more dangerous and more emotionally loaded. To secure oil supply for transportation could become a question of existential significance for certain countries.

The U.S. has the world's largest economy and it is also the most dependent on transportation for its domestic economic structure. It has also the most powerful military in the world, which is vulnerable to lack of oil. Its air force and its navy will not be able to exercise global dominance if they run out of oil and they will not be able to transport the army to places where its presence is deemed necessary. This becomes a really remarkable fact, when one realizes that the U.S. is also the country that has most eloquently and consistently argued for the benefits of a well functioning free market for oil. Since the United States is the country in the world with the fastest growing and biggest demand for imported oil, one may wonder how long it will take until the principle of free trade for oil globally becomes difficult to uphold. The policies of the European Union, Japan, and South Korea are not dictated by military considerations to the same extent as the American policy, but they also lack domestic oil resources and transportation is vital for their economies.

The economies of the developing countries are often hit harder and faster by an increase in the price of oil and gas than the economies of the countries of

the industrialized world. The two largest emerging economies of the world, China and India, also have large military forces and attach great importance to their operational capability. Both have ambitions, at least at sea, to be able to exercise "power projection" beyond their immediate neighborhood. For historic reasons there remains in both India and China a great deal of mistrust about the benefits of globalization and principles of the free market. When energy needs are discussed, there is less natural resistance against resource nationalism than in the Western countries.

We have some examples in history of the dangers that are hidden in zero sum games. Adolf Hitler's original plan for the attack on the Soviet Union in the summer of 1941 entailed as one of the two most important constituents a push through southern Ukraine in order to get secure access to the oil fields in Baku.[10] Accordingly, to secure supply for the German forces and to cut off the Soviet supply seems to have been an important reason for his final decision to open a second front.[11]

In September 1941, Japan's leaders decided to go to war with the United States if an agreement regarding oil had not been reached by early October. When an American oil embargo against Japan, introduced in July, was still not lifted by October, plans for war were initiated. On December 7, the Japanese fleet attacked Pearl Harbor.

In July 1990 the author of this paper happened to be an eye-witness to the failure of the last negotiation in Basra between Iraq and Kuwait, before the first Gulf War started. The subject of that negotiation was the oil fields on the border between the two countries, and the failure of the negotiations was an important reason for Saddam Hussein's decision to attack Kuwait four weeks later, on August 1.[12]

This is the kind of geopolitical reasoning that makes "secure supply of oil" a strategic question, which is often discussed in other terms than those of economic, geologic, physical, or even political science. Military and political

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[10] Although other ideas about "race superiority" originally were the real motive, see Hermann Rausching, *Gespräche mit Hitler* (New York: Europa Verlag, New York, 1940), pp. 120-27.
[11] Werner Maser, *Adolf Hitler: Legende-Mythos-Wirklichkeit* (München:Wilhelm Heine Verlag, 1975), pp. 499-503.
[12] Ingolf Kiesow, *Svensk – Kuwait* (Stockholm: Probus förlag, 1993), p. 30.

aspects become more important and more opaque for the outside world. This is why it would seem to be a truly serious issue to not only counter the emerging tendencies towards zero-sum thinking and preserve the existing mechanisms for free trade in oil and gas, but also to find ways and mechanisms to consider the needs of all countries during a time of fundamental changes.

II. Symptoms

Shock rises in the price of oil no longer spell disaster for the global economy. Can that be true? The price of oil has risen eight times since the end of the 1990s, counted in US$, and is now at a substantially higher level than during the "disaster years" in the 1970s. And yet there is no sign of the same economic panic as the one that grasped the stock markets 25-30 years ago. As a commentator in *Dagens Nyheter* wrote: "The world has accustomed itself to a high oil price, which is fair, when concerning a finite resource. Not even if the oil should seriously dry out would that mean any economic crisis."[13]

The above is a truth worth remembering, but another point should also be made: developing countries find it much harder than industrialized countries to absorb the effects of the oil shock. In many cases it has serious social and political consequences, and even for such a strong economy as that of China, the rise of the oil price above US$100 per barrel means a large increase in inflation, which has already reached around 8.7 per cent annually (in February 2008).[14]

Certainly the price rise in oil has been fastest since 2003, when the level was around US$24-28/barrel. But why before this long period of nervousness hit the markets were there so many different signs of the coming problems? The answers can be summarized in three ways, namely:

- Growing structural instability in several producer countries.
- Rapid increase in demand and limited increase in production in some key consumer countries.

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[13] Johan Schück, "Chockhöjt oljepris betyder inte längre ekonomisk kris [Shock raised oil price does no longer mean economic crisis]" *Dagens Nyheter,* November 16, 2007.
[14] "China's Fuel Dilemma," *BBC News*, November 2, 2007; available at: http://newsnote.bbc.co.uk/mpapps/pagetools/print/news.bbc.co.uk/2/hi/asia-pacific/7075 (accessed November 6, 2007); "Inflation tops China's 2008 agenda," *BBC News, Asia Pacific*, March 5, 2008, available at: http://news.bbc.co.uk/2/hi/asia-pacific/7278450.stm (accessed March 10, 2008).

- Fears of "Peak Production," meaning that global oil and gas production seems to be in decline rather than increasing, thus creating a world-wide gap between increasing demand and declining power production. This factor has already been described in the first chapter.

Expensive Oil

Reason 1: Political Unrest

Domestic ethnic and social strife in combination with political violence has hit (and can still be seen to exist in 2008) countries such as Nigeria,[15] Saudi Arabia, Iraq, Sudan, Indonesia, and Venezuela. With the exception of Venezuela, all of the above are Muslim countries and the civil unrest is related to conflicts between traditionalist and more modern ways of thinking, which would seem to be a phenomenon set to stay for many years to come and is likely to get worse before it improves – if it ever does. It is not only a conflict between modernists and traditionalists, but it is also a matter of competition between Shi'i and Sunni sects and between Sufi, Deobandi, and Wahabbi ways of life and methods of interpreting the Koran. Oil and Gas is found mainly in Muslim countries. In the case of oil more than 65 per cent of all assets are found there.[16]

In Venezuela, a deep rift between totalitarian socialism and liberal modernists is plaguing the country, and there are few signs that promise better conditions in the foreseeable future.

Political unrest means higher investment risks, and investments by local capitalists in oil production equipment have been lagging behind for many years, which is part of the explanation for the rise in oil price. Saudi Arabia has declared its ambition to raise oil production capacity by 3.5 million barrels a day (Mb/d), but there are doubts abroad as to whether enough risk-willing capital can be raised even in this dollar-rich country. This is significant because Saudi Arabia has been able during previous years to use its production capability in the service of all the OPEC countries as a buffer

[15] A more serious civil war was declared by the Movement for the Emancipation of the Niger Delta in September 2008.
[16] "World Proved Reserves of Oil and Natural Gas," *Oil & Gas Journal*, January 1, 2007, available at: http://www.eia.doe.gov/emeu/international/reserves.html (accessed March 10, 2008).

between higher and lower price levels, so that a more or less stable price level could be maintained. That does not seem to be the case anymore, as OPEC declarations have considerably less influence on the price level for oil today in comparison to the situation during the 1990s.[17]

Iran is in conflict with the U.S. over its nuclear ambitions and, in addition to some limited UN sanctions, the already previously existing legislation regarding economic sanctions against Iran has been set in force.[18] This has led many companies, both abroad and in the U.S., to abstain from investments in Iran, which in turn results in a tendency toward less capacity for oil and gas production.

International terrorism of the kind that resulted in the attacks on the World Trade Center in New York and on the Pentagon has led the U.S. to declare war on terrorism. That war has inter alia been fought in Afghanistan and Iraq, but the way in which it has been fought has caused strong anti-U.S. and anti-Western sentiments all over the Muslim world. These sentiments constitute a political force that is likely to have a negative influence on the chances for Western countries to conclude long-term contracts with Muslim countries over the delivery of oil and gas in the future. Since Western countries (including Japan) account for a majority of the world's oil and gas consumption, this could mean a further increase in the prices for these commodities (and the fears of this development are likely to be another part of the explanation for the price increase). Price increases are more likely if and when market conditions continue to change from the free market, with business mainly on the spot market, to state purchasing of oil fields for exclusive export to the owner, a phenomenon that will be discussed later in this paper.

In Russia, several oil and gas companies were made into state enterprises during Vladimir Putin's presidency by methods that have frightened off

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[17] Ali Hussain, "Supply/Demand: Security of Oil Supply and Demand and the Importance of the 'Producer-Consumer' Dialogue," *Middle East Economic Survey*, Vol. XLIX, No. 50 (December 11, 2006); available at: http://www.mees.com/postedartciles/oped/v49n50-50D01.htm (accessed March 10, 2008).

[18] "Security Council heightens sanctions against Iran over uranium enrichment," *UN News Centre*, March 24, 2007; available at: http://www.un.org/apps/news/story.asp?NewsID=21997&Cr=Iran&Cr1 (accessed March 10, 2008).

potential foreign investors, engendering fears that Russia will face problems relating to capacity in the near future.[19] Fears abroad about risks for foreign capital in Russia have been reinforced by what seems to be a spectacular unfriendly bid to take over the assets of TNK-BP and make it an entirely Russian affair.[20] At the same time, the liberal EU rules for foreign investors in Europe have been misused by Gazprom to purchase a number of key European companies in the energy sector, which has aroused calls for intervention.[21]

Reason 2: Growing Gaps between Demand and Supply in Key Countries

Particularly in Asia, but elsewhere as well, gaps between demand and supply have emerged with rapidly increasing economic expansion and a resulting increase in demand for oil and gas, clearly showing the weakness caused by non-existent domestic resources (as in Japan, Taiwan, and South Korea) or insufficient resources (as in China, India, and Indonesia). This development was most obvious between 1980 and 2003, when the present trend of rapidly increasing prices started in a serious way. It is also part of the explanation for the new trend that has been ongoing since 2003.

China is a good example. It consumed 1.8 million barrels a day (Mb/d) in 1980 and produced 2.2 Mb/d. That made it possible to export 0.4 Mb/d and China continued to be a net exporter until 1993. Ten years later, in 2003, however, China consumed 5.6 Mb/d and was only able to raise its production of oil to 3.5 Mb/d. That meant a need to import 2.1 Mb/d.

India demonstrates a similar scenario. In 1980, it consumed 0.6 Mb/d and produced 0.2 Mb/d, which necessitated an import of 0.4 Mb/d. However, due to rapid economic growth, oil consumption had risen to 2.3 Mb/d in 2003, but production could not be raised to more than 0.8 Mb/d. As a consequence, 1.5 Mb/d oil had to be imported.

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[19] Ken Koyama et al., *Russian Oil/Gas Development and Its Implications for Japan*, (Tokyo: The Institute of Energy Economics, Japan, 2006), available at: http://eneken.iee/jp/en/data/pdf/402.pdf (accessed March 10, 2008).
[20] "TNK_BP: The End Begins," *Stratfor today*, September 4, 2008.
[21] Vladimir Socor, *Independent Oil Producers in Russia: Analysis, Outlook and Assets,* quoted in *Alexander's Oil & Gas Connections,* September 8, 2008 available at: http://www.gasandoil.com/goc/news/ntr83665.htm.

Japan has almost no domestic oil production, and in 1980 it imported all of its oil needs or 5.0 Mb/d. In 2003 this figure had not risen to more than 5.4 Mb/d, partly due to slower economic growth but also, and possibly more importantly, through a methodical and successful campaign for energy conservation.

The sum of these developments is that the three main oil consumers in Asia in 1980 consumed 7.4 Mb/d compared to a sum of 13.4 Mb/d in 2003. That meant that they had to import 4.0 Mb/d more in 2003 than in 1980 and that China could not export the 0.4 Mb/d that it had been able to sell in 1980. In other words, the energy demands of the three major consumers in Asia necessitated an increase in world oil trade of around 12 per cent between 1980 and 2003, which naturally entailed pressure for a price rise.

This, however, is not the most prominent reason for greater pressure in the increase in world oil trade; that comes from the U.S. The U.S. import of oil rose from 6.7 Mb/d in 1980 to 13.5 Mb/d in 2005. During the same period, the United States' share of the world's total import of oil has increased from 21 per cent to 27 per cent.

This increase is of the same size as that of for Europe and Asia combined and yet, for some reason, it is rarely mentioned in international debates on the energy issue. Attention has so far focused on the more spectacular cases of the rise of China and India.

What happened with the giant consumer that is the United States? Firstly, sources of oil dried out somewhat more rapidly than expected. That meant a reduced self sufficiency and, as a result, the price of oil has become a serious problem for President George W. Bush. Today, the U.S. is consuming 20 Mb/d but only producing 5 Mb/d. The rest, 15 Mb/d, has to be imported. Domestic production is in fact slowing down even more. In 2006 new oil fields and new reservoirs in existing oil fields containing 73 million barrels were discovered and added to its "reserves." Estimated domestic production amounted to 1.652 million barrels in the same year. This means that reserves declined by 785 million barrels and the present figure for the American share of the world's oil reserves (1.8 per cent) will be reduced successively.[22]

[22] "Crude Oil Proved Reserves, Reserves Changes, and Production," *US Energy Information Administration*, Release Date: 1/2/2008; available at:

Consumption, on the other hand, is not slowing down; it continues to grow by around 2.5 per cent each year, and the U.S. is today importing as much as, or even more than, Europe, where there are only insignificant domestic resources.

No wonder that a new national energy policy is being discussed and that energy conservation is such an important issue in some U.S. states, particularly in California under the governorship of Arnold Schwarzenegger.

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http://tonto.eia.doe.gov/dnav/pet/pet_crd_pres_dco_NOS_a.htm (accessed March 10, 2008).

III. Consequences of Expensive Oil: A Race for Oil & Gas

A Race for New Fields

The competition between consumer states over raw energy materials has already resulted in a race for oil and gas in Central Asia and Siberia. Since new fields of natural gas are more available for new contracts and as environmental concerns have made gas more attractive as a cleaner source of energy, competition has been especially obvious in the case of gas. In Central Asia, American, European, and Asian companies are struggling for new contracts and aiming to sway states through high level visits by government officials. Above all, it is a race for the rich gas fields in Kazakhstan and Turkmenistan, and here China has been seen to be very active at the official level, while Russia has been struggling to remain the sole outlet for Kazakh and Turkmen oil and gas, as it had been during Soviet times when Kazakhstan and Turkmenistan were still part of the Soviet Union. Meanwhile, European and U.S. companies have cooperated to obtain a second outlet through Turkey to Europe, albeit in this case without overt government support.[23]

In Siberia it is mainly Chinese and Japanese companies who vie for the right to use new Siberian natural gas fields (or at least to receive the gas at the other end of the pipeline), for which both countries have offered to finance construction costs on generous conditions. In this respect, China had to give in to the competition, because it could not afford to offer conditions as favorable as those offered by Japan; but visits by ministers and even the President of China to Moscow have resulted in Russia having not yet decided in favor of Japan, from where the Japanese Prime Minister also visited

[23] "Franco-Turkish Dispute Overshadows Nabucco Project," *Euractiv.com*, available at: http://www.euractiv.com/en/energy/franco-turkish-dispute-overshadows-nabucco-project/article-170424 (accessed March 10, 2008).

Moscow in order to solicit the support of the now ex-president, Vladimir Putin.[24]

In Latin America, Canada, and Africa south of the Sahara there are still oil and gas fields being offered for bidding to foreign companies, with Chinese and Indian companies being backed by their governments in order to gain the upper hand in the competition. China has offered weapon sales and development aid in support for long term contracts over energy in some African countries.[25]

In Canada, China has been operating through a Hong Kong based company in order to gain control over some vast new fields of oil and tar sand.

Another consequence of the increasing pressure for oil and gas is the declining importance of OPEC in determining the price of oil. The OPEC states, especially Saudi Arabia, have usually kept free a reserve production capacity to be used as a buffer between demand and supply.

Most of these reserve capabilities, including the Saudi one, have lately been used for deliveries, since companies and governments have not been able to resist the temptation to sell when the price has been close to US$100 per barrel. As a consequence, the statements about price levels from the OPEC heads of state meetings have lost much of their importance for the setting of oil prices.[26]

In Latin America, Venezuela's socialist president Hugo Chavez has tried to create a common front with other emerging socialist governments to stop selling to the U.S., but in the cases of Bolivia and Brazil this initial enthusiasm for cooperation cooled off considerably when it came to oil and gas. However, Hugo Chavez has promised to "liberate" Venezuela from its

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[24] "Japan, China firms sign energy accords," *The Japan Times*, April 13, 2007, available at: http://search.co.jp/cgi-bin/nb20070413a4.html.

[25] Princeton N. Lyman, "Testimony: China's Rising Role in Africa." Presentation to the US-China Commission, Council on Foreign Relations, July 21, 2005, available at: http://www.cfr.org/publication/8436/8&q=Middle+East+Policy+Council+web+site&btnG=Google-s%C3%B6kning&lr=(accessed September 22, 2004); *Al Jazeera News Agency*, available at: http://english-aljazeera.net/HomePage (accessed November 1, 2004); "China emerges as a major energy player," *Alexander's Gas & Oil Connections*, Vol. 9, Issue #17, 2004, available at: www.gasandoil.com/goc/frame_cns.company.htm;

[26] Jim Jubak, "OPEC Drives Up Oil Prices In A New Way," available at: http://finance.sympatico.msn.ca/investing/jimjubak/article.aspx?cp-ducumentid=5448669.

dependence on the American market for its oil exports and officially invited India and China to replace the U.S. as customers.[27] Some agreements have been made at the state level in the case of China, but the Indian government has been cautious not to get directly involved, seemingly out of consideration for the U.S. However, some contracts over Indian access to deliveries from Venezuela have been made at the business level. When these preliminary negotiations were made with Indian companies it prompted opposition from the U.S.

When the U.S. officially criticized China for breaches against the principles of free trade in its "field-hunting," India had to be criticized in the same way – but it was much milder in the case of India, mainly because the Indian oil and gas companies are mostly private and do not sell their oil and gas exclusively to the home country (as the Chinese state-owned companies are supposed to do; at least in a crisis situation).

[27] "lndia takes stake in Venezuela oilfield," *Aljazeera*, available at: http://english.aljazeera.net.

IV. Non Asian Main Actors

Russia

Russia is selling most of its raw energy materials to Europe. It is estimated to possess 6-7 per cent of the world's oil reserves and 27 per cent of the world's reserves of natural gas, which makes it a major player on the international markets.[28] However, the resources are limited. At the present rate of production, known reserves of oil will only last for 20 years, compared to Iran where the oil will, theoretically, last for 138. In the case of gas the situation seems to be much better for Russia. It is also situated between Europe and Asia and is a great supplier of energy raw materials to both regions.

"Ensuring National Security is the fundamental task of the energy policy," according to *Russia's Energy Strategy*, a document published in 2003.[29] Since security for one may mean insecurity for another nation, Russia has been accused of using its energy assets to blackmail others whilst being egoistic. That is true in some respects, but to be fair, there are also three quite "legitimate" reasons for this state of affairs.

- There is a need for the "new" Russia to define the rationality of how much and how fast it should make use of its own resources.
- There is also a need to know exactly by scientific methods how much Russia possesses, how much it needs for itself, and for how long these raw materials can be sold without limiting Russia's own consumption.
- Environmental considerations have to be established as well as how much that will limit the use of oil and gas (a problem that is often emotional and sometimes misunderstood).

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[28] *BP Statistical Review of the World Energy,* available at: http://www.bp.com/productlanding.do?categoryId=6842&contentId=7021390

[29] Robert Larsson, *Russia's Energy Policy: Security Dimensions and Russia's Reliability as an Energy Supplier*. FOI-R—1934 (Stockholm: Swedish Defence Research Agency, 2006), p. 48.

Even if the process of investigation is underway, the results have still not materialized. Meanwhile, a great number of decisions have to be made without having a complete and detailed picture. This can make the policy seem more erratic and nationalistic than it actually is, and it partly, but only partly, explains why Russia's oil and gas policies can look different from region to region.

Attention was suddenly focused on the problems with Russia's image as a supplier of oil and gas, when Georgia was attacked in August 2008. Europe's great dependence on supply from Russia and Central Asia was highlighted and the emotional reactions by the Russian leaders caught much attention. Much was said about how the Russian leaders must feel obliged to respond to domestic expectations by adopting a strong stance when Russian and European interests collide. Dependence on Russian deliveries suddenly seemed perilous for Europeans.

At the other end of the country, development of Russia's Siberian assets of oil and gas are ongoing in a slow but rather methodical way. The Sakhalin projects number I and II have incurred some unexpected cost increases as well as by nationalization of some foreign shares in the projects. Environmental arguments have been used in a way that has discouraged some investors from future projects,[30] but on the whole Sakhalin I and II are seemingly being carried out according to plan.

Russia is considering building pipelines from the Baikal region for export of oil and gas to a harbor on the Pacific coast, near Vladivostok. In order for this to happen, a pipeline for oil needs to first be drawn from Baikal to connect the long trans-Siberian web of pipelines. Russia wants to first make sure that it will get oil and gas for its own use, before it can begin to export.[31]

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[30] "Russia: State will seek to revise Sakkhalin -2 agreement," *Oxford Analytica*, November 21, 2006, available from: analysis@oxford-analytica.com. See also Shoichi Itoh, *Can Russia Become a—"Regional Power" in Northeast Asia? Implications from Contemporary Energy Relations with China and Japan,* Written for the Center for East Asian Studies, Monterey Institute of International Studies, May 2006, p. 28.

[31] At the same time, it has been said that Russia wants to make sure that oil can be transported in the other direction: when and if it takes a longer time than projected to make the East Siberian oil-fields productive fast enough, oil will have to be taken from West Siberian fields to fill in the gap that may arise, according to contracts that will soon have to be made. Izuru Yokomura, "Despite the boom times, is Russia ready to go it alone?" *Asahi shimbun*, available at: http://gasandoil.com/goc/_ntr_news.htm.

A pipeline for oil, later to be completed with one for gas, is being constructed from Tayshet in East Siberia via Skovorodino near the Chinese border to Kojimo Port near Nahodka on the Sea of Japan – the so called ESPO project (East-Siberia-Pacific Ocean). Negotiations have continued with China about constructing a bifurcation plant at Skorovodino to connect it with the Chinese web of pipelines, but Russia is still working to make sure that there is enough oil in the wells for supply to both the international market – where Japan is supposed to be the most important consumer – and for China. On the surface, this has looked like a competition in power politics between Japan and China. Certainly both countries have used economic and political means at the highest level. In Moscow, however, economic factors seem to have been at least equally important as possible considerations about political relations.[32]

In Asia (and in Western Europe) *economic* considerations seem to have been more important on the whole for Russia than what has often been the case in its relations with the former Soviet states, especially Belarus, Ukraine, and the Central Asian states, where *political* considerations have had a comparatively higher priority for Russia.[33] It should, however, be noted that political and strategic factors considerably complicate the picture in Asia. The former Russian president, Vladimir Putin, has been criticized in his own country for binding the export of oil and gas by favoring construction of pipelines to markets in Asia, where the customers can dictate the price (which, it is claimed, can be avoided by instead pumping Siberia's oil and gas from centers in western Siberia to ice-free ports in Murmansk).[34]

United States

About 50 per cent of the United States' oil imports come from the Western hemisphere. Three large suppliers, Canada, Mexico, and Venezuela, account for over 40 per cent of deliveries to the U.S. A study of the energy situation in the United States[35] finds that U.S. dependence on energy supply will

[32] Larsson, *Russia's Energy Policy*, p. 295.
[33] Ibid., p. 296.
[34] Vladislav Inozemtsev, "The President Exaggerated," *Nezavisimaja Gazeta*, September 2006.
[35] Hans von Knorring and Robert Larsson, eds., *Energisituationen i USA och amerikansk energipolitik*. FOI-R—2308—SE (Stockholm: Swedish Defense Research Agency, 2007).

remain great and that room for self sufficiency is small – in spite of ambitious plans for energy saving and greater efficiency in production and use of energy.[36] As a consequence, U.S. engagement in energy supplying regions of importance and oil transport lanes will remain very strong.

Other conclusions are made as well: at present the U.S. is suffering from several structural and mutually incompatible targets in relation to its energy policy.[37] According to a leading article in the *Oil and Gas Journal* in 2007: "US Drivers continue to harbor the notion that they can have it all: gasoline prices that won't affect their driving habits, less carbon dioxide emissions, and a broader menu of cleaner fuels. For instance: environmental parameters stand against security of supply and economy."[38]

Another observation is that there are differences between U.S. energy policy and the energy policy which has been pursued by a number of European countries. One illustration of these differences is that U.S. energy taxes are low while in Europe they are much higher. Another example is that receptiveness to environmental arguments is considerably higher in Europe than in the U.S.

In January 1989, George Bush became President of the United States and on August 2, 1990 Saddam Hussein invaded Kuwait, a state bordering Saudi Arabia where the most important oil fields are situated. These and the entire global oil supply were under threat. For Bush the first priority was to acquire the support of King Fahd in Saudi Arabia, and this he managed to do in addition to gaining support from a broad coalition, including the Soviet Union, the United Kingdom, France, and Germany. He also declared that "Saudi Arabia's sovereign independence is of vital importance for the United States."[39]

On the whole, this military conflict was largely caused by oil. After the war a change was noticeable in the geopolitics of oil, in that an element of stability was introduced. Washington had retaken its position as the world's leading "oil power." The U.S. and Saudi Arabia together were responsible for the global order in relation to the energy market. Saudi Arabia delivered the oil

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[36] Ibid.
[37] Ibid., p. 13
[38] David Nakamura, "You can have it all," *Oil & Gas Journal,* July 16, 2007, p. 15.
[39] von Knorring and Larsson, *Energisituationen i USA och amerikansk energipolitik,* p. 36.

and the U.S. in turn guaranteed it protection. For both exporters and importers the goal for oil policy became to stabilize the price level so that it satisfied the major players on the market. The oil price should be low enough so as to avoid hurting the oil companies or the oil states and not so high that it would hurt the consumers of oil. Another factor for the intervention seems to have been consideration for the situation of the Asian countries and their need for oil. Disturbances in the supply chain from the Middle East to the countries of Asia could have had global consequences.[40]

On the surface there seem to be many similarities between European and U.S. energy policies, and as a result they could cooperate in many ways. In reality, however, there also remain important differences. It is, for instance, a U.S. interest to prevent Europe from becoming overly dependent on Russia for energy raw materials such as oil and gas. For Europe, on the other hand, Iranian energy is a potentially important substitute for Russian deliveries but the U.S. prefers Europe to import from Russia.

There is also a difference in that U.S. foreign energy policy confirms and reinforces the trend toward accelerating unilateral and/or bilateral state policies in the field of energy rather than multilateral solutions and the use of spot markets that is preferred in Europe.

Europe

Europe has experienced a relatively calm development in the field of energy, at least when compared with other regions. Economic growth has been slower than in the U.S. during some years in the period 1980-2003, but more importantly the Europeans, like the Japanese, have made strong and partly successful efforts to save energy. The Japanese success story is the most remarkable one, but that of the Europeans is also nothing to be ashamed of. Imports amounted to 12.2 Mb/d in 1980 and in 2003 it had grown to 13.3 Mb/d, an increase of only 1.1 Mb/d. This explains why, until recently, there has rarely been the same feeling of near desperation in Europe, when energy needs are discussed, as is sometimes the case in Asia and the U.S.

It may also explain why the Europeans have been so reluctant to take seriously the repeated warnings from the U.S. government in strategic

[40] Ibid., pp. 36-37.

discussions within the NATO framework about the danger of Europe becoming more dependent on continued deliveries of natural gas from Russia.

Almost all European countries are members of the European Union. It is a political and economic community with supranational and inter-governmental features. It is more than just a federation of countries – but not a federal state.[41] Energy is one field that is not mentioned by the EU Charter, and it has not yet been made a field for common policy and is therefore also not covered by the binding rules for the members. There are, on the other hand, many aspects of energy policy in which members have to observe binding rules in other fields – where the Union does have a common policy – as for instance in the field of the environment.

There are also many reasons why there is a tendency to move toward some form of coordinated policy, even possibly a common policy in the formal meaning of the charter. The European Commission has made one "Energy Overview" and has been working on a new such overview to be presented toward the end of 2008. It has also set up a task force on external energy policy.

The IEA has reviewed the energy policies of the European Union which shape the energy use of almost 500 million citizens in 27 EU member countries. According to the report:

> Since 2005, some major events made energy security of supply a major issue in European energy policy. These events include the rapid rise of fossil fuel prices since 2004; the interruption of gas supplies from Russia in January 2006, with resulting gas shortages in a number of EU member states, and the continuing threat that disputes between neighbouring suppliers and transit countries will affect supplies of gas and oil to the EU. [...] Energy security is a pressing issue in energy policy and has rapidly risen up the European Commission's priority list,

[41] International Energy Agency, ed., *IEA energy policies review : the European Union 2008*, (Paris: IEA 2008), p.11.

> because of increasing import dependence of the EU, and high energy prices.[42]

The report from the IEA further states that at present:

> co-operation with supplier and transit countries takes place within multilateral frameworks such as the World Trade Organization and the Energy Charter Treaty, through regional initiatives such as the Energy Community Treaty (to which the European Community is a party) and in the bilateral context through Partnership and Co-operation Agreements and Free Trade Agreements, which provide legally binding rules for the energy sector. Energy is also a key element of the European Neighbourhood Policy. Memoranda of Understanding in the energy field have been concluded with producer and major transit countries such as Kazakhstan, Turkmenistan, Azerbaijan, and Ukraine, and through joint declarations with Morocco and Jordan. The EU-Russia Energy Dialogue serves as the main vehicle of co-operation in the energy sector between the EU and its main external supplier.[43]

The lack of a united EU policy in the field of energy, the very different supply situations of the member countries, and their consequently differing policies may also explain why reactions were so mixed and the debate so heated when Russia attacked Georgia after the Georgian use of military force to restore order in South Ossetia in August 2008.[44] With support from the U.S., European oil companies had tried for many years to construct a means of transportation of oil and gas from the Caspian Sea region to Europe and the Mediterranean Sea without having to cross Russian territory. There are already two operating pipelines for oil running through Georgia from the oil fields in Baku on the Caspian Sea: one via Tbilisi to the Georgian harbor of Supsa on the Black Sea, and the other via Tbilisi to the Turkish harbor of

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[42] Ibid., p. 59.
[43] Ibid., p. 80.
[44] See Svante E. Cornell, Johanna Popjanevski, Niklas Nilsson, *Russia's War in Georgia: Causes and Implications for Georgia and the World,* Central Asia-Caucasus Institute/Silk Road Studies Program, *Policy Paper*, August 2008.

Ceyhan on the Mediterranean Sea. The flow of oil was temporarily affected during the Georgian-Russian conflict.

The Caspian Sea region is more important for its resources of gas than for those of oil, however, and a pipeline for gas is already operating from Baku via Tiblisi to Erzerum in Turkey, where the gas is distributed to consumers in Turkey. The flow of gas was also disrupted during the conflict.

This pipeline has the potential to become of major strategic importance. It is planned to be connected via a pipeline under the Caspian Sea from Turkmenbashi in Turkmenistan, with its very large gas fields, and then on the other side via Turkish territory to Europe, the so called Nabucco project. According to the IEA:

> The Nabucco project represents a new gas pipeline connecting European markets with the Caspian region, the Middle East and potentially Egypt via Turkey, Bulgaria, Romania, Hungary and Austria. The pipeline is designed to open the fourth supply corridor for natural gas into Europe, after the North Sea, North Africa and Russia, enabling new suppliers from the Caspian and the Middle East regions to access the European gasmarket. [...] The pipeline length is foreseen to reach approximately 3 300 km, starting at the Georgian/Turkish and/or Iranian/Turkish border, with 2000 km crossing Turkey, and sections of 390/400/460 km crossing Hungary, Bulgaria and Romania. The pipeline will end with a 46 km connection from Hungary into the Baumgarten gas hub in Austria, whence gas will be entering the European grid to be further transported through Austria to the central and western European markets.[45]

This situation was sufficient to cause anxiety in Europe, when Russia unexpectedly started a war with Georgia in August 2008 and took control over the territory where these pipelines are situated. The threatening atmosphere of present and possible future conflicts was reinforced by several statements in Moscow. A British newspaper report stating that Russia was telling its oil companies to cut off other shipments to Europe was immediately denied by the Russian Energy Minister, but the Prime Minister

[45] *IEA energy policies review*, p. 71.

also told the press that "if NATO chooses to cut ties with Russia nothing terrible will happen to Moscow" and Putin announced that "World Trade Organization membership no longer interests Moscow." Feelings of a new Cold War were ventilated in many parts of Europe during the following weeks and reminders of European dependence on Russian supply of energy raw materials were frequent. Two countries, Russia and Norway, together account for 44 per cent of EU oil imports, and Russia is the most important gas supplier, accounting for 42 per cent of EU27 gas imports, exclusively through pipelines.[46]

The Russian statement came at a time when the EU countries were deliberating whether to impose sanctions on Russia for its attack upon Georgia and there were differing opinions within the Union. France relies on nuclear power for its main supply of energy and therefore little dependent on Russian supply, and France was accordingly one of the leading voices calling for sanctions along with the United Kingdom, which is also not very much dependent on Russian supply (its own North Sea resources and imports from Norway make it less exposed). Other countries with heavier dependence on Russia, like Germany and the Central European states, opposed the idea of sanctions. This embarrassingly open conflict of interests among the member countries became a painful reminder of Russia's possibility to use oil and gas as political weapons.

It may be true that in reality that weapon should not be overestimated, since to use it will probably hurt Russia's own economy harder than it will hurt Europe. The psychological effect has nevertheless been considerable.

The U.S. Government has recently renewed its warnings to Europeans (with considerably better response) about paying more attention to the perils of dependence on gas deliveries from Russia and areas, like Central Asia, which are easily manipulated by Russia.

The Energy Charter Treaty

There are hopes that the spirit expressed in the EU Energy Charter Treaty (ECT) can be a guideline for an international policy of cooperation,

[46] Ibid., p. 62.

something that would appear necessary to create. The ECT is a multilateral treaty over the energy sector, which establishes legal rights and obligations.[47]

Its aim is to strengthen the rule of law on energy issues, by creating a level field of rules to be observed by all participating governments, thereby mitigating risks associated with energy-related investment and trade. The ECT

> assists by offering binding protection for foreign energy investors against key non-commercial risks, such as discriminatory treatment, direct or indirect expropriation, or breach of individual investment contracts. Another priority for the treaty is to promote reliable international trade and transit flows. Under the Treaty, member countries are under an obligation to facilitate energy transit in accordance with the principle of freedom of transit and not to interrupt or reduce established energy transit flows.[48]

The principles have helped EU countries to establish a reasonably free flow of energy between its members and also with Russia, who has accepted the Energy Charter declaration in principle but has thus far not signed the treaty. China and the U.S. are observers to the treaty and Japan is a full member, while India is not even an observer.[49]

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[47] *The Energy Charter Treaty in 2000: In a New Phase*, available at: http://iis-db.stanford.edu/evnts/3917/Charter.pdf

[48] "Energy Charter: Trade &Transit," available at: http://www.encharter.org/index.php?id=5 (accessed 2008-10-02)

[49] "Energy Charter: Members and Observers," available at: http://www.encharter.org/index.php?id=61 (accessed 2008-10-02)

V. Asia

According to the IEA,[50] primary energy demand in the world will increase by 66 per cent from the year 2002 to 2030. Asia's share will increase from 28 per cent to 35 per cent. The share increase will be especially significant as regards oil demand. Asian developing countries will account for the largest share, 38 per cent in 2030. China will account for 16 per cent and India 8 per cent. India's demand will more than double during the same period.[51] India will also increase its share of the total consumption of natural gas and coal. Imported oil will constitute a greater part of consumption in Asia, increasing its share of the total consumption from 42 per cent in 2002 to 83 per cent in 2030. This of course is only possible if sufficient amounts of oil can be delivered by the producers.

The Political and Strategic Situation in Central and South Asia

In the South Asia region, the U.S. military is trying to keep a low profile – but with little success. The main reason for its presence are the serious developments that could occur if Pakistan's domestic problems lead to political disintegration, which could result in its nuclear weapons falling into the hands of radical Muslim elements, with unforeseeable consequences for the whole region. The possibility that developments in Afghanistan could follow the same route and return the country to radical Islamic authoritarian control is a very strong reason for the U.S. to stay on with its troops, both there and in Pakistan, for as long as that danger prevails.

Elsewhere, Iran may develop nuclear weapons and unexpectedly announce their existence. The U.S. will find it extremely dangerous to take preventive measures in such a situation or launch a preventive war. A war or an armed

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[50] "IEA-India Workshop on Emergency Oil Stock Issues: Opening Remarks by Ambassador William Ramsey, Deputy Executive Director of the IEA," available at: http://www.iea.org/dbtw-wpd/Textbase/speech/2004/ramsay/india.pdf (accessed February 9, 2005).

[51] Ibid.

conflict with Iran, possibly with Israel as an ally, would engender serious consequences for the U.S., both economically and politically. It could mean the end of its status as the undisputed and sole global superpower, and as a result, this scenario remains only a small possibility, with Washington likely to try and avoid conflict at all costs.

Chinese and Russian ambitions to play a role in Afghanistan have had limited success given Russia's history in Afghanistan and China's lack of history there. On the other hand, China's ambitions to gain access to the Indian Ocean make for a closer relationship with Pakistan than it otherwise would like to have, given its desire for good relations with India. The Pakistani factor constitutes a main obstacle for further progress in efforts to improve Sino-Indian relations, which the leaders of both countries often talk about so eloquently, especially in the economic field.

Russia, on the other hand, has little interest in Pakistan as opposed to longstanding strategic relations with India that it wants to continue.

The quest for oil and gas lead both China and India to consider with greater focus the need for safe Sea Lanes of Communication, especially in the Indian Ocean, and that again gives added weight to the course of Pakistan and Iran who are likely to remain major players in the strategic situation in Asia for as long as oil and gas continue to be the most highly valued raw materials for energy production. The U.S., Russia, China, and India all have high stakes but not necessarily compatible interests in the Sea Lanes of Communication between the Middle East and South and East Asia.

Iran-India-U.S.

India continues with some degree of success to enhance its connections with Iran, partly because India needs Iranian gas and oil and partly because India has great power ambitions and wants to use Iranian influence to its own advantage or at least see to it that Iran does not turn against India; both on the regional and on the global level in terms of, for instance, "protecting" the Shi'i minority in India as well as abetting terrorism in the country. India is making considerable efforts to woo Iran; and Iran seems to be quite receptive to this courtship. India's more specific interests in Iran are related to the strategic situation in the Indian Ocean – the need to keep the Sea Lanes of

Communication to the Persian Gulf open – and to have an uninterrupted supply of oil and gas.

India has initiated maritime cooperation with the U.S. and is responding positively to invitations to play a policing role together with the latter in the Indian Ocean. But, on the other hand, it is not willing to abstain from the import of gas from Iran via a pipeline through Pakistan, in spite of U.S. warnings. On the whole, India's strategic attitude is a matter of uncertainty for the region, because of the tensions between modernists on the one hand and communists and nationalists on the other – and eager U.S. efforts to have India as a strategic partner or even an ally.

This uncertainty is heightened by U.S. efforts to have a closer relationship with Pakistan, and its failures in this respect. Whether the next U.S. president will continue the policy of courting India (as a balance to Chinese influence in Asia) at the same time as it tries to help preserve stability in Pakistan and wage the war on terrorism both from Pakistan and Afghanistan, will contribute a great deal to the strategic picture in South West Asia.

Central Asia and the Regional Powers

Russia is pressing to maintain its appearance as a "hegemon" in Central Asia, primarily in order to remain in control over the outflow of oil and gas from Central Asia. Iran, with its coastline on the Caspian Sea, is an important counterpart in this power-game. Russia's power game with Iran is complicated by the fact that Iran is the only major country in the Islamic world that has a population dominated by Shi'i believers. The rift between the Sunni and Shiite schools of Islam is unlikely to disappear (and as long as the situation in Iraq is not under control). It could create a dangerous situation in the Gulf and in Afghanistan and worsen the rift that already exists in Pakistan. That rift between Sunni and Shi'i communities can basically only be mended by the Muslim nations, but continued U.S. presence in Iraq and Afghanistan could make that task more difficult.

Since the beginning of the troubles for Russia in Chechnya, it has been important not to alienate Iran to the extent that Iranian support for the uprising in Chechnya could occur. Russia's importance on the stage of world politics has been enhanced by threatening to vote in the Security Council

against U.S. proposals for UN sanctions against Iran and by defending Iran's position internationally in certain instances of cooperation with China. Iran is of importance to Russia as another major exporter of oil and gas. All these interests are long-term and not likely to change in the near future.

Russia and China cooperate in the Shanghai Cooperation Organization (SCO) to maintain their influence in Central Asia. Iran, Afghanistan, and Pakistan are all invited as observers. The SCO is being used as an instrument to counter increasing U.S. influence in Central Asia and now possibly in South West Asia as well – with Russia and China likely to continue this policy.

There are, however, also competing interests between Russia and China in the region. Russia is not welcoming of China's growing influence as a buyer of Central Asian oil and gas and of its efforts to create new and direct outlets that do not cross Russian territory.

Imported natural gas is becoming increasingly important for China, illustrated by the construction of a great number of pipelines across the country, from west to east. The longest pipeline stretches 9,100 kilometers and was started in 2008. It will carry gas from the North-Western Xinjiang Uighur Autonomous Region, bordering on Kazakhstan, to Shanghai and connect with South China's Guangdong Province and Hong Kong. At the other end, another project has been started that will connect gas fields in Western Kazakhstan with Xinjiang across another few thousand kilometers of desert.[52]

Russia's strong bonds with India do not match China's strategic bonds with Pakistan, and Russian deliveries of advanced weapons to India are another matter of concern for China, who is helping Pakistan to develop military hardware, and whose threat to India was given as the main reason for India's nuclear test explosions in 1998.

Russia's and China's different outlooks became obvious to all in the SCO debates about Russia's attack on Georgia in August 2008. At a summit meeting in Tajikistan, Russia did not receive any backing from China over

[52]"2nd West-East Gas Pipeline Project in Construction," *Alexander's Oil & Gas Connections*, August, 22, 2008, available at: http://www.gasandoil.com/goc/news/nts83468.htm.

its recognition of the two breakaway Georgian provinces. What emerged was largely a compromise between Russia and China. While the Group welcomed "Russia's active role in contributing to peace and co-operation in the region," it condemned the use of force and reaffirmed its support for the sovereignty of the countries involved.[53]

Afghanistan, Pakistan, and the U.S.

Only three months after the formation of the coalition government between the Pakistan People's Party (PPP) and the Pakistan Muslim League Nawaz Party (PML-N) the differences became so strong that the coalition government collapsed. PML-N is now supporting the PPP in parliament, but no longer as part of the government. The coalition was made up of the two political parties that bear responsibility for the failed economic policy during the 1980s and the widespread corruption that caused the military take-over. A renewal of that situation would inevitably mean that the radical elements, who were a threat to the stability of Pakistan in late 2007 and early 2008, would gain credence again and that the tensions between the Pashtu segment of the population and the others would increase. It would constitute a new risk for disintegration.

It may not happen as long as the situation in Afghanistan remains under control, but if the disorder continues there and if U.S. forces are withdrawn, a radicalization of the Sunni population in both countries is likely to take place and worsen relations, both with the moderates and with the Shiites. That could increase the risk of a worsening Sunni-Shiite rift in Iraq, especially if U.S. forces in Iraq were also to be withdrawn. A connection between events in Afghanistan and Iraq is quite evident, both in the U.S. debate about whether or not troops should be withdrawn and also when Al Qaeda make their public statements regarding Iraq and Afghanistan. This is likely to remain a feature for as long as U.S. troops stay in the area, not least because their presence *per se* is a strong reason for the anti-U.S. feelings among the populations in both Afghanistan and Pakistan, as well as in Iraq.

[53] "Shanghai Cooperation Organisation Cautiously Endorses Russia over Georgia," *World Socialist WebSite*, September 3, 2008, available at: http://www.wsws.org/articles/2008/sep2008/sco-s03.shtml.

If U.S. forces remain for a longer period, there is a growing risk of further radicalization in the region.

A Pakistan ruled by a radical Sunni regime – a development that most Pakistanis would say is unrealistic, at least until recently – would represent a threat for both the U.S. and Iran and other countries, not least because of the presence of nuclear weapons. The U.S. will try to obstruct any development in that direction but may not be able to stop it.

For the U.S., the question is not only about Iraq or Afghanistan or Pakistan. They are all interconnected, and, as such, all decisions are likely to affect the entire region. They will, moreover, have an impact upon the following:

- East Asia's and South Asia's supply of oil and gas from the Gulf;
- Thus having ramifications for the global economy;
- The safety of the Sea Lanes of Communication in the Indian Ocean;
- The American policy of containment of China.

China

China's Energy Needs

As a consequence of uninterrupted, strong economic growth for more than a decade, China became the second largest energy consuming nation in the world (after the U.S.) in 2006. It is the largest consumer of energy in Asia, and the 3rd largest importer of oil in the world.[54]

There was an energy crisis in China in 2003. It was caused by several factors. One was a sudden collapse of the traditional annual bidding procedure in the coal sector. Another reason was declining coal production, caused by efforts of the authorities to decrease coal consumption and discourage investment in the coal sector. Congestion of the railway system because of an overload of coal then became an added reason.

China's Import Sources and International Relations

In 1990, the Middle East accounted for 40 per cent of China's oil imports, whereas the share of Asia and Oceania – areas which used to be regarded as

[54] IEA, *Key World Statistics 2006*, available at: http://library.iea.org/textbase/nppdf/free/2006/key2.

trustworthy and secure sources of supply – constituted 60 per cent. There were practically no imports from Africa, the EU, Central Asia, or others.

By 2001, the share of the Middle East had increased to 56 per cent. The share of Asia and Oceania had gone down to 14 per cent, and Africa now supplies 23 per cent of imports. China suddenly has become dependent on a number of more distant countries with low political stability. China's security in its supply of energy raw materials has thus worsened remarkably.[55]

China Tendency Number 1: Owning Oil and Gas when Loaded

In order to compensate somewhat for the instability factor, it has been an openly admitted, but not outspoken, policy to try to "own the oil when loaded" just as is the case with Indian oil companies.

This has provoked strong criticism from the U.S. over deviations from the road of economic liberalism. This was initially quite damaging for China, for having only just joined the World Trade Organization in 2000, it had to be seen as acting in accordance with its rules.[56]

China Tendency Number 2: Avoiding Transportation Risks

The security of the Sea Lanes of Communication is being discussed seriously in China. Industry circles in Shanghai have suggested that tanker ships should be built in sufficient quantities to be able to carry 50 per cent of China's import of oil. Convoys should be arranged and military vessels should protect them. This idea has been criticized by economists in Shanghai and elsewhere in China. It remains to be seen if anything will come out of these discussions.[57]

There is a belief among military analysts in the region and the West that China has an ambition to gain a dominating position by means of force projection: 1) over its energy arteries, most notably the Sea Lanes of Communication from the Persian Gulf; 2) over the petroleum reserves in the

[55] Ingolf Kiesow, *China's quest for energy: Impact on foreign and security policy*. FOI-R—1371—SE (Stockholm: Swedish Defence Research Agency, 2004), p. 13.
[56] Ibid., p. 40.
[57] Philip Andrews-Speed, Xuanli Liao and Roland Dannreuther, *The Strategic Implications of China's Energy Needs,* Adelphi Paper 346 (London: The International Institute for Strategic Studies, 2002), p. 78.

South and East China Seas; and 3) over the entries to the Strait of Malacca and beyond.[58]

Under the influence of such fears, the development of a Chinese tanker fleet capable of carrying half of China's oil import needs can easily be construed as being likely to lead to a decision on the military level to give the PLA Navy the necessary resources to protect the sea lanes. A mandate of that kind could entail a risk of unfriendly competition with U.S., Indian, and other naval units with the same ambition to protect the free passage for their own ships. Australia is greatly dependent on imported raw materials from Africa and the Middle East through the Malacca Strait, and Australian Prime Minister Kevin Rudd has announced a big increase in military spending, giving as a reason the ongoing "arms race" in the Western Pacific.[59] India has been apprehensive about China's growing naval expansion in the Indian Ocean, which Delhi views as encirclement.[60]

The risks are under review and means are being sought to contain them. This is demonstrated by the fact that Chinese academics are suggesting that an oil pipeline be constructed from Burma to China in order to reduce the country's dependence on oil imports shipped through the Strait of Malacca (at present about 60 per cent of China's total oil imports). According to media reports, Chinese Premier Wen Jiabao and the then Burmese Prime Minister Khin Nyunt discussed plans for an oil pipeline when they met in June 2004 in Beijing.

This idea has been criticized, however, for not taking into consideration the problems of further transporting the imported oil from the mountainous areas near the Burmese border to the centers of high consumption in China.[61]

Another similar idea has been discussed, namely to unite with South Korean and Thai business groups to construct a pipeline across the Malay peninsula,

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[58] Ibid., p. 78.
[59] "Asian reaction to Kevin Rudd's military expansion plan," *ABC Radio Australia*, September 10, 2008, available at: http://www.radioaustralia.net.au/programguide/stories/200809/s23612809/s2361280.htm.
[60] Dipanjan Roy Chaudhury, "China Boosting Maritime Capabilities in the Indian Ocean,"*Asia-Pacific*, August 23, 2008, available at: http://www.worldpress.org/Asia/2908.cfm.
[61] *Interfax News*, available at: http://www.interfax.com/com?item=Chin (accessed September 20, 2004).

so that oil can be pumped from the Andaman Sea to the Gulf of Thailand and then be taken by ship to China.[62] As far as is known, this idea has not yet been discussed in serious negotiations on the governmental level between the countries concerned. In another direction, China is also trying to reduce the risks for transportation of oil at sea. China is building a harbor in Gwadar on the Pakistani coast and is discussing a Pakistani plan for a possible pipeline from Gwadar to China.

China Tendency Number 3: Playing the Developing Country Status Card

A foreign policy commentator in Beijing has made the following statement:

> Western monopoly capital, with the support and assistance of their governments, has scrambled and seized the main oil and gas resource markets in all parts of the world. Almost all good resource markets have been occupied and possessed by them. There is intense competition among different groups of monopoly capital. All of them will certainly try even harder to impede Chinese companies from obtaining these resources.[63]

This statement may reflect a temptation for simplification, which comes from reading too many troublesome reports in the West about the effects of Peak Production of oil. However, in the international context, the present leaders in China prefer to talk about cooperation and they hopefully still think in that way. Whether they will continue to do so will depend very much on the responses from the United States and the EU – and here we may have a problem. As more and more articles appear in the press about the approaching peak in oil production, increasing political instability in most oil producing nations and the need to cut down on emissions, especially in China, leaders may feel "contained" by other nations, who only think of continuing their present life-style without being willing to accommodate China's (and India's) wish for a life with the same qualities as those now being enjoyed in the West.

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[62] Oil pipeline may transform maritime order in Straits of Malacca, *Alexander's Gas & Oil Connections,* available at: http://www.gasandoil.com/goc/news/nts.

[63] Amy Myers Jaffe and Steven W. Lewis, "Beijing's Oil Diplomacy," *Survival,* Vol. 44, No. 1 (2002), p. 127.

Territorial Disputes about Energy

The People's Republic of China has territorial disputes with Japan about areas rich in oil and gas in the East China Sea. There are also incompatible claims on islands in the Pacific called the Senkaku Islands in Japanese and the Diaoyutai Islands in Chinese, as well as over some other minor islands and reefs.[64]

A pattern of controversy has repeated itself in the South China Sea, where the often bloody skirmishes with Vietnam over the Spratly Islands have caught the attention of news media. For the time being, this problem has been swept under the carpet by an agreement among all the ASEAN countries to apply internationally agreed rules for the peaceful resolution of conflicts. It should, however, be observed that China has not withdrawn any of its claims registered at the United Nations in connection with the 1966 ratification of the United Nations Convention on the Law of the Sea regarding the disputed areas in the South China Sea.[65] Does this mean that the matter is solved?

India

The fast population growth, the high density of its population, and the agricultural character of its economy has put strains on India's available natural resources and has limited the domestic supply of raw energy materials. Increasingly problematic air pollution and serious shortages of electricity necessitate a greater import of cleaner forms of raw energy materials, mainly natural gas.

A substantial part of energy consumption is in the form of the burning of so-called non-commercial fuels like fuel-wood, dung, and crop residue. More than 60 per cent of Indian households still depend on these traditional sources of energy. It is especially pronounced in the countryside. Out of the total rural energy consumption, about 65 per cent is met through fuel-wood. Coal is by far the most important primary fuel, constituting some estimated

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[64] Ingolf Kiesow, *Ambitions and perils in the Western Pacific*. FOI-R-0266—SE (Stockholm: Swedish Defense Research Agency, 2001).

[65] Ingolf Kiesow, ed., *From Taiwan to Taliban; two Danger Zones in Asia,* FOI-R-0393—SE (Stockholm: Swedish Defense Research Agency, 2002); United States Energy Information Administration, "The South China Sea Region," 2001, available at: www.eia.doe.gov (accessed August 21, 2001).

55 per cent of the supply in 2006, according to the calculations of the Indian Energy and Resources Institute (TERI).[66] Crude oil is the second most important contributor to energy supply, accounting for 32 per cent of the total. Natural Gas will be in short supply and will not increase its share of about 15 per cent of the total in 2006.

It is not expected that oil can increase its share of the total, since there is already a great gap between domestic demand and domestic supply and that gap is set to widen. Imported oil has been used for about 70 per cent of consumption, but it supplied around 88 per cent in 2006 and that figure is likely to increase to more than 95 per cent, according to the International Energy Agency.

Consumption of petroleum products is growing faster than what domestic production can meet. The import of oil increased by 6.3 times during the years 1970-2002, while domestic production only increased by 4.5 times, making import dependency as high as 73.3 per cent in 2002. The problem has been accentuated by a slowdown in investments in refinery capacity and pipelines due to a certain recession in Asian economies toward the end of the last millennium, which also affected the Indian economy.[67] The IEA is calculating that, with unchanging conditions, India will be dependent on oil imports for as much as 94 per cent of total demand in 2030.[68]

India's oil industry is still almost entirely state-owned and comes under the Ministry of Petroleum and Natural Gas. Under pressure to increase the import of oil, the state-owned Oil and Natural Gas Corporation (ONGC) has acquired exploration blocks abroad in Burma, Sudan, Iraq, Russia, Vietnam, Venezuela, and Libya. It has also begun a deep-water drilling program in the Bay of Bengal. The private sector company Reliance Industries Ltd. is pursuing a plan for equity and acquisition of oil and gas fields in Yemen, Oman, Colombia, East Timor, and Australia.[69]

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[66] Ibid., p. 4.
[67] "IEA-India Workshop on Emergency Oil Stock Issues: Opening Remarks by Ambassador William Ramsey"
[68] Ibid.
[69] "Growth through Energy Security for India," Reliance Industries Limited, available at: http://www.ril.com/html/business/exploration_production.html

The Indian energy policy has not been very clearly defined. In its series of Energy Security Studies that the Brookings Foreign Policy Studies have published about India[70] the author, Tanvi Madan, says that:

> There is a sense that in an oil crisis, relationships will count for more than ownership of assets. For the time being, oil diplomacy is intended to help on a number of fronts: aiding Indian companies to win deals, ensuring secure supply, laying the groundwork for cooperation, attracting investment and technology, and encouraging investment from producer countries in India's downstream sector to ensure that they have a vested interest. [...] A former diplomat described successful oil diplomacy as "getting in first with exploration contracts, negotiating bilateral, trilateral and multilateral agreements, and ensuring that our future energy security is safeguarded through all this."

The Indian Junior Minister for petroleum and natural gas, Dinsha Patel, announced on February 29, 2008 that in the last three years, government-controlled companies have acquired participating interests in 35 oil and gas projects in 20 countries. Especially interesting is his comment that "while in normal circumstances, oil/gas could be sold on commercial consideration, in times of national requirement, the same can be brought to India irrespective of commercial considerations."[71]

The Indian state-owned oil companies carry out a security policy for the nation and this is not going to be changed. In other words, India is not going to accept the principles of the Energy Charter in the foreseeable future. That is also an impression that has been reconfirmed by the author in conversations with Indian researchers. They point to the uncompromising attitudes toward the effects of globalization from the trade unions and communist parties, whose support is necessary for the Congress Party-led government in Parliament.

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[70] The *Brookings Foreign Policy Studies Energy Securities Series: India*, available at: http://brookings.edu/fp/research/energy/2006.pdf (accessed March 5, 2008).
[71] "Indian firms buy 35 oil, gas assets abroad," *United Press International*, February 28, 2008, available at: http://www.upi.com/International_Security/energy/Briefing/2008/02/28/indian_firms (accessed March 6, 2008).

India and the Regional Powers

India's ambition to increase the share of oil that is imported from Indian-owned fields abroad has led to many situations where an Indian company has found itself in competition with a Chinese company. Former Oil Minister Mani Shankar Ayer has even accused China of using unfair methods of competition, when for instance Indian companies lost out on oil-fields in Kazakhstan.[72] Chinese companies have also won over their Indian competitors in bidding for oil fields in Angola, Nigeria, and Sudan.[73]

The increasing competition within the small international market for oil fields forced the two governments to consider the advantages of cooperating on oil projects.[74]

In order to mitigate Chinese reactions and continue a good-will policy toward China – which has already led to important agreements about economic cooperation and regulation of border issues – the then oil minister Shankar Ayar proposed to China that a pipeline be constructed from the Middle East through India to China. However, since Ayar left his post at the beginning of 2006, not much more has been heard about these plans.[75]

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[72] "India's energy security," *Alexander's Gas & Oil Connections*, January 12, 2006, available at: http://www.gasandoil.com/goc/news/nts60225.htm

[73] "China and India in oil investment race," *Alexander's Gas & Oil Connections*, available at: http://www.gasandoil.com/goc/news/nts
"Regeringen sänker indisk oljesatsning," [The government disrupts Indian oil exploration], *Svenska Dagbladet*, December 19, 2005.

[74]"China/India: Energy cooperation will not come easily," *Oxford Analytica*, January 16, 2006, available at: http://www.oxan.com/Display.aspx?S=EES&SD=20060116&PC=OADB&SN=3&S

[75] "India and China begin to see more value in cooperation than competition," *Alexander's Gas & Oil Connections*, January 12, 2006, available at: http://www.gasandoil.com/goc/news/nts52796.htm (accessed December 27, 2006); "China's Energy Acquisitions," *PINR Dispatch*, September 2, 2005, available at: http://www.pinr.com/report.php?ac=view_report&report_id=359&language_id=1 (accessed December 27 2006); "India eyes alliance with China and Uzbekistan for oil assets," *Alexander's Gas & Oil Connections*, December 8, 2005, available at: http://www.gasandoil.com/GOC/news/ntr54914.htm (accessed December 27, 2006); "Indo-Iran pipeline can be pulled to Southern China via Burma," *Alexander's Gas & Oil Connections*, March 10, 2005, available at: http://www.gasandoil.com/goc/news/nts51008.htm (accessed December 27, 2006).

U.S. Grand Strategy Pits India against China

America wants to stop India from getting too close to the Shanghai Cooperation Organization. Since the beginning of this millennium, the U.S. has been offering India closer collaboration across many areas. It has offered India an agreement over military cooperation, which has been accepted, and technology for civilian nuclear power, which has also been accepted, albeit with strong opposition from communist and Hindu Nationalist circles in India.[76]

The U.S. is now offering India nuclear civilian technology and a solution to its problems with the Nuclear Suppliers Group (NSG) – but is not offering the same to Pakistan. It was the U.S. that first took the initiative within the NSG to impose sanctions, when India and then Pakistan conducted nuclear test explosions in 1998. It is also the U.S. that has persuaded the other member states to lift the sanctions against India.[77] As soon as this approval had been obtained, President Bush sent the text of the nuclear agreement with India to Congress for approval, obviously anxious to have this new policy well established before the end of his mandate.[78]

That policy is likely to cause problems with Pakistan. If the U.S. is now trying to make an ally of India, it is likely that Pakistan will become even closer to China and this could grow into the emergence in Asia of two competing power blocs. In the field of energy, this will impact on the security of the SLOCS in the Indian Ocean. China is building a harbor in Gwadar on the Pakistani coast and is discussing a Pakistani plan for a possible oil pipeline from Gwadar to China – and China is participating in common military exercises with Pakistan in the Indian Ocean. In addition, Pakistan and China are set to cooperate over the development of the next generation of jet-fighters to be built in China.

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[76] "BJP asks govt to reject US-nuke deal," *Kashmir Times*, December 12, 2006, http://www.kashmirtimes.com/front.htm (accessed December 12, 2006).

[77] "International alliance approves U.S.–India nuclear deal," *Los Angeles Times*, September 7, 2008, available at: http://www.latimes.com/news/nationworld/world/la-fg-usindia7-2008sept07,0,139955

[78] "Bush sends US-India Nuclear Deal to Congress," *Voice of America*, September 11, 2008, available at: http://www.voanews.com/english/2008-09-11-voa23.cfm?renderforprint=1.

Therefore, at the same time as India has been negotiating over cooperation in the field of energy with China (bilaterally as well as in the SCO and other fora) there is the Pakistani-China factor, which together with the Indo-American rapprochement constitutes the beginning of a complicated power game in Asia. And it all circles around energy in the form of oil, gas, and nuclear technology.

Japan

Toward the end of the 20th century, Japan's energy demand almost stopped growing, mainly due to a slowdown in economic activity, and has since then been "hovering" around the same level. It is projected to grow slowly or even to decrease until 2030, since the population is decreasing, economic growth is not predicted to pick up in pace, and fuel efficiency in vehicles is expected to continue.[79]

Notwithstanding the above, Japan is still the third largest consumer of oil in the world (after China) and will remain so for a long time to come. Japan competes with all nations in Asia over raw energy materials. There is especially intense competition with China over oil and gas fields within the reach of sea transport. The security of the sea lanes is a common matter of concern as well as a possible bone of contention, depending on the relations between these two countries.

Oil has been reduced as an energy source, from 65 to 47 per cent between 1980 and 2005, and its share is projected to continue to decrease until it reaches 37 per cent in 2030. There is almost no domestic oil available. Just as in China and India, Japan relies heavily on imported oil from the Middle East: 89 per cent of its imported oil comes from this region. Government restrictions and regulations have historically limited the role of international oil companies in Japan. Since May 2006, Japan has a "New Energy Policy." The *New Strategy* states that new policy should focus on:

[79] These findings are supported by Japan's Agency for Natural Resources and Energy, see http://www.enecho.meti.go.jp/english/index.htm; the International Energy Agency, see "Energy Policies of the IEA Countries; Japan 2003 Review," available at: http://www.iea.org/Textbase/country/index.asp; and the Institute of Energy and Economy, Japan.

> strengthening governmental support in supplying risk money for overseas exploration and development activities by Japanese oil companies. To expand measures to streamline and upgrade multi-and complex refineries and to advance Research and Development of innovative technologies to make use of non-conventional oil.[80]

In other words, the government is subsidising oil and gas companies in their efforts to purchase oil and gas fields abroad and to increase their refining capacity at home. Even if Japanese companies are private, they receive government support (in order to be able to compete with Chinese and Indian companies).

On the other hand, Japan is behaving in line with the Energy Charter, to which it has subscribed. In that sense, Japan is the most free trade-friendly country in Asia.

Energy and Japan's Territorial Borders

Gas fields on the bottom of the sea between Japan and China have been in dispute for many years. They are situated in the East China Sea near the so-called median line, a concept defined in Article 15 of the 1982 United Nations Convention on the Law of the Sea (UNCLOS).[81] That line has been drawn by Japan as an implementation of the new rules of the convention over 200-nautical-mile Exclusive Economic Zones (EEZ), but this has never been recognized by China.[82]

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[80] Tsutomu Toichi, "Oil Market of Today and Tomorrow," speech held in Kuala Lumpur, July, 2006, available at: http://eneken.iiej.or.jp/en/data/pdf/345.pdf (accessed October 2, 2008)

[81] For the text, see *United Nations Convention on the Law of the Sea,* available at: http://www.un.org/Depts/los/conventionagreements/texts /unclos/part2.htm.

[82] See *Upon ratification,* China, *Declarations or Statements upon UNCLOS ratification,* available at: http://www.un.org/Depts/los/conventionagreements/convention_declarations.htm. Articles 55-57 define the concept of an Exclusive Economic Zone (EEZ), which is an area up to 200 nautical miles beyond and adjacent to the territorial sea. The EEZ gives coastal states "sovereign rights for the purpose of exploring and exploiting, conserving and managing the natural resources, whether living or non-living, of the waters super adjacent to the seabed and its subsoil." However, Article 76 also says that "The provisions of this article are without prejudice to the question of delimitation of the continental shelf between States with opposite or adjacent coasts." There is less than

In the issue of the Diaoyutai/Senkaku islands south of Japan, giving the right to these islands to China would cut away a great part of the EEZ from Japan and give the rights to gas exploitation to China.[83] There are two disputes here, one about whether to apply the principle of the median line, as claimed by Japan, or to apply the principle of the continental shelf, as advocated by China, and secondly, concerning who is the rightful owner of the Diaoyutai/Senkaku islands.

The question of whether to apply the principles of the median line or the continental shelf would mean a difference in the borderline between the economic zones from near the strait between Japan and Korea and southwards until near the Ryukyu islands. The issue of the Diaoyutai/ Senkaku islands has implications for drawing the border from the Ryukyus almost down to Taiwan, with there being natural gas on the bottom of the sea in both these areas.

A Serious Background

Energy issues are but one element in the complicated pattern of Sino-Japanese relations, which have a long history spanning over 2000 years of war and competition for power in the region. The seriousness of the problem was demonstrated when a Chinese submarine cruised, submerged, and intruded upon the waters of Japan in 2005. It caused the Japanese Self-

400 nautical miles between the land masses of China and Japan, and even if one of the articles of the convention stipulates the use of the median line in such a conflict of claims, this is contrary to the stipulation in the convention about the use of the principle of the continental shelf. Article 76 says that "the continental shelf comprises the seabed and subsoil of the submarine areas that extend beyond its territorial sea [...] to the outer edge of the continental margin [...]" Article 77 stipulates that the coastal state can exercise the right of exploring and exploiting the natural resources of the continental shelf. Moreover, upon ratification of the UNCLOS in June 1996, China made a statement that "In accordance with the United Nations Convention on the Law of the Sea, the People's Republic of China shall enjoy sovereign rights and jurisdiction over an exclusive economic zone of 200 nautical miles and in accordance with the principle of equitability...China reaffirms its sovereignty over all its archipelagos and islands as listed in article 2 of the Law of the People's Republic of China on the territorial sea and the contagious zone [...]."

[83] Another chain of small islands, Okinitori, is giving Japan an even larger claim for an EEZ, larger than the land area of Japan itself, but that area has a greater importance from a military perspective than as a potential gas field. See "Pacific power play puts Japan and China between a rock and a hard place," *The Guardian*, April 5, 2005, available at: http://www.guardian.co.uk/china/story/0,7369,1452414,00.html

Defense Forces to go on alert for only the second time since WWII. The incident caused obvious consternation in Beijing, and Japan received an official apology from China: it had been "a mistake."[84]

Energy as a CBM between China and Japan

The visits by Prime Minster Abe to Beijing in 2006 and by Prime Minister Wen Jiabao to Tokyo in April 2007 can be seen as serious efforts by the leaders to put a stop to an otherwise ongoing escalation of dangerous actions and reactions between the two countries. An act of traditionally great symbolic value was made during Wen's visit to Tokyo: the two prime ministers decided to set up a 24-hour hotline between their armed forces to prevent incidents in the waters between them.[85]

Complications

Japan and China continue to have conflicting interests of major importance. As mentioned above, Japan has been lobbying hard in Moscow to persuade Russia to accord priority to building an oil pipeline from Tashet in Eastern Siberia near Lake Baikal to a harbor on the Sea of Japan. Russia has only agreed to start building a pipeline for export of oil via the halfway point of Skorovodino, which is situated near the border to China. China, on the other hand, has been lobbying for a continuation from Skorovodino to the oil fields in Daiqing in Northeast China, where it would connect to the existing nation-wide web of oil pipelines. Japan's former Prime Minister Koizumi succeeded during a visit to Moscow in 2006 in having President Putin sign an agreement to accelerate talks on the so-called Pacific route, which would entail the continuation from Skorovodino to the coast; but there has been no further commitment on the Russian side. The pipeline monopoly Transneft will begin with building the stage to Skorovodino during 2008.

After that, there is still no decision over the continuation of the pipeline; and nationalistic elements in both China and Japan have engaged themselves in the debate. Energy is at the same time seen as a potential source of conflict in

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[84] "Chinese submarine enters Japanese waters," available at: http://en.wikinews.org/wiki/Chinese_submarine_enters_Japanese_waters.

[85] "Japan, China to set up military hotline," *Reuters,* April 21, 2007, available at: http://edition.cnn.com/2007/WORLD/asiapcf/04/16/japan.china.hotline.reut/index.html.

relations between China and Japan and, as such, is seen as a potential field for Confidence Building Measures of great significance.

VI. The Korean Peninsula and the Six Nation Talks

For North Korea, energy supply is a burning issue. Already in 1975, North Korea had become increasingly dependent on thermo-electric power and when oil deliveries dried up, the transportation system suffered. Ox-carts began to re-appear on the high-ways instead of tractors, trucks began to use wood-gas instead of gasoline, and many factories stood still for long periods of time. It was clear that North Korea was undergoing an energy crisis. Weapons deliveries and deliveries of ammunition were made to Iran during the 1980–1988 war with Iraq (that made the latter break diplomatic relations with North Korea) and was a sign of how desperately North Korea needed more oil (provided by Iran). North Korea was already beginning to feel structural strains during the 1980s in two obvious respects, namely food and energy. In both respects, the downturn continued.[86]

The ensuing lack of electricity also caused a continuing degradation of industrial facilities, much reduced availability of electricity in most parts of the country, and damage to operating industrial electric motors from poor quality electricity. Industrial activity was hurt to the extent that eyewitness reports have claimed industrial facilities were being dismantled for scrap. The problems were a vicious circle: the lack of electricity led to the flooding of mines and difficulties in coal production, thereby further reducing the available amounts of energy, which in turn led to a continuing decline in cement and steel production, etc.

During the so-called NPT withdrawal crisis in 1994, when North Korea actually withdrew from the Non-Proliferation Treaty, the situation went so far as to cause President Clinton to seriously discuss plans for a military attack on North Korea's nuclear assets. These discussions in the White House were, however, suddenly interrupted. The event that interrupted the

[86] Ingolf Kiesow, *Perspectives on North Korea's nuclear and missile programs*. FOI—R—12009—SE (Stockholm: Swedish National Defense Research Agency, 2004), p. 25.

discussions was a call from ex-President Jimmy Carter, who had been able to obtain an invitation from Kim Il Sung to visit Pyongyang and who had also been permitted to go by Vice-President Al Gore. He had been thoroughly briefed by the chief negotiator for North Korea, Robert Galucci, but he had no formal authorization as a negotiator. Carter now reported over the telephone from Pyongyang that he had been offered by Kim Il Sung that North Korea would remain in the NPT, and that the North would freeze its nuclear weapons program in exchange for a package of benefits that was in many ways similar to what had already been offered in separate contexts.[87] After some additional clarifying of U.S. conditions and another telephone conversation with Carter, who forwarded the contents to Kim Il Sung, the deal was made in principle and it was left to negotiators in Geneva to hammer out the details.[88] On October 16, 1994 an "Agreed Framework" between the U.S. and North Korea was initialed in Geneva by the two delegations, headed by the same negotiators who had been responsible for negotiations during the entire crisis, namely Robert Galucci on the U.S. side and Kang Sok Yu on the North Korean side.[89]

The main elements of the agreement are summarized as follows:

- The United States would organize an international consortium to provide light-water reactors, with a total generating capacity of 2,000 megawatts, by a target date of 2003. In return, North Korea would freeze all activity on its existing nuclear reactors and related facilities, and permit them to be continuously monitored by IAEA inspectors. The eight thousand fuel rods unloaded from the first reactor would be shipped out of the country.
- North Korea would come into full compliance with the IAEA, which meant accepting the "special inspections," before the delivery of key nuclear components of the LWR project, estimated to be delivered within five years. The DPRK's existing nuclear facilities would be completely dismantled by the time the LWR project was completed, which was estimated to be in ten years.

[87] J. Michael Mazarr, *North Korea and the Bomb: A Case Study in Nonproliferation* (London: Macmillan, 1997), p. 163.
[88] Don Oberdorfer, *The Two Koreas: A Contemporary History*, Rev. ed. (New York: Basic Books, 2001), p. 330.
[89] Ibid., p. 173.

- The United States would arrange to supply 500,000 tons of heavy fuel annually to make up for energy forgone by North Korea before the LWRs came into operation.
- The two states would reduce existing barriers to trade and investment and open diplomatic liaison offices in each other's capitals as initial steps toward the full normalization of relations. The United States would provide formal assurances against the threat or use of nuclear weapons against North Korea.
- North Korea would implement the 1991 North-South joint declaration on the demilitarization of the Korean peninsula and reengage in North-South dialogue.[90]

Most of this never happened. A consortium was formed, called the Korean Peninsula Energy Development Organization (KEDO), between the United States, Japan, and South Korea to provide North Korea with light water reactors, but North Korea refused – as it had said it would – to accept that the reactors were explicitly specified to be of South Korean design and produce. The target date passed without delivery. North Korea did not allow full inspections, referring to non-fulfillment by the U.S. side. The fuel rods have been canned, but they have not been shipped out of North Korea, since no LWR has been delivered. Also for the same reason, North Korea's nuclear facilities were not dismantled until the so-called six-party talks in Beijing had resulted in a new basic agreement in 2007. Due to financial difficulties KEDO failed in its annual delivery of 500,000 tons of heavy fuel oil, some years only delivering a minor fraction of that commitment and in 2003 no oil at all. The U.S. has not reduced the barriers to trade with North Korea. There is no diplomatic liaison office in any one of the capitals. There has, moreover, been no demilitarization on the Korean peninsula.

It is clear that one of the potentially most dangerous issues in the world, namely North Korea's nuclear ambitions, not only has its roots in North Korea's need for energy and difficulties in getting access to energy at affordable costs, but also that a solution has to be found to that problem if North Korea is to abstain from completing its domestic nuclear program,

[90] Ibid., p. 357.

which, given its history, will always cause suspicions abroad of the manufacture of nuclear weapons as a by-product.

Of course a great deal of effort has been dedicated to this issue. The six-party-talks in Beijing resulted in a deal in February 2007 with the following elements:

- North Korea is to "shut down and seal" the Yongbyon reactor, then disable all nuclear facilities (once more);
- In return, it will be given 1 m tonnes of heavy fuel oil (once more);
- Under an earlier 2005 deal, North Korea will agree to end its nuclear program and return to the Non-Proliferation Treaty (once more);
- North Korea's demand for a light water reactor is to be discussed at an "appropriate time" (once more).

North Korea has fulfilled most of its promises, but, as this is being written, it still has not provided any clarification on its supposed uranium enrichment program, and there is a standstill in the entire six-party process.[91]

[91] "N Korea abductions hamper Japan," *BBC News*, March 4, 2008, available at: http://newsvote.bbc.uk/mpapps/pagetools/print/news.bbc.co.uk/2/hi/asia-pacific/7252 (accessed March 4, 2008).

VII. The Regional vs. the Global Context

Incompatible Perceptions

China and India, with close to 40 per cent the world's population, are already being confronted with the following questions:

- Is owning oil and gas when loaded a wise policy?
- Does it make sense to spend enormous sums to avoid transportation risks?
- Is it realistic to try to establish partnerships with producers with an exclusive character – and how to react when energy supply becomes involved in strategic game playing?
- Should Developing Countries be given a special handicap in the race for raw energy materials?

Owning oil and gas when loaded is a principle that does not constitute a breach of any explicit WTO rule, but could perhaps be said to be against the spirit of the GATT charter, although that interpretation is far-fetched.

With regards to the Energy Charter Treaty, on the other hand, it is quite clear that its spirit is against any measure that restricts free flow and access for all buyers. Chinese and Indian practices on the one hand and European, U.S., and Japanese views on the other are not compatible.

However, let us not forget how the Indian Junior Minister for petroleum and natural gas described the Indian attitude, namely that "while in normal circumstances, the oil/gas could be sold on commercial consideration, in times of national requirement, the same can be brought to India irrespective of commercial considerations."[92] The "field hunting policy" is a preparedness measure for the case of emergency that is considered necessary by the government of a developing country with limited cash resources and with a

[92] "Indian firms buy 35 oil, gas assets abroad," *United Press International*

billion inhabitants. One may of course wonder why it then should be so difficult for the Indian government to accept the principles of free flow of raw energy materials contained in the Energy Charter Treaty, but since there have not been any negotiations, this question is never raised. And consequently, the other question is also never raised: namely whether it would really be so difficult for the members of the treaty, especially the European countries, to accept the principle that very large developing countries must be allowed room for special preparedness measures and, therefore, to make some exceptions from the rules of the charter.

Expensive Energy: Geostrategic Thinking

The academic world now has a task to alert politicians and public opinion to the growing need for geostrategic thinking, whether we like it or not. This should address the inherent danger of the wrong approach to such thinking regarding the supply side of the problem. It is an understatement to say that part of the problem is how to present solutions in a way that make them plausible as alternatives to zero sum gaming.

However, the alternative is definitely unattractive. It is likely to be that China and India, ultimately even the U.S., EU, and Japan, will begin to "play hard-ball" in the race for raw energy materials. In a worst case scenario, China and India will align themselves with an increasingly anti-Western Muslim world in the hope of replacing the U.S., Japan, and the EU as traditionally the "best" customers in world oil and gas trade.

The Importance of North East Asia

There is an important regional context to the energy problem in Korea. South Korea could use gas and oil from the Russian Sakhalin projects, as could Japan, but the pipelines would have to pass through North Korea. The same is true of electricity that could be produced by existing power plants in Eastern Siberia and sold to Japan and South Korea. Also, the northeastern parts of China could be supplied with Russian electricity, as they are already supplied to some extent. If this regional network of pipelines and electricity power transmission lines became reality, it would, however, require that North Korea open up and permit the construction of these facilities – in return for deliveries of power and power raw materials that it needs so badly.

There obviously remains a whole series of regional energy negotiations that are waiting to be conducted, and both China and North Korea are developing countries when it comes to their need for energy. From an outsider's viewpoint, it would seem that it would benefit all *if* the parties could agree to what extent the following principles should apply, namely:

- To strengthen the rule of law on energy issues;
- To create a level field of rules to be observed by all participating governments, thereby mitigating risks associated with energy-related investments and trade;
- To offer binding protection for foreign energy investors against key non-commercial risks, such as discriminatory treatment, direct or indirect expropriation, or breach of individual investment contracts;
- To promote reliable international trade and transit flows, and;
- To facilitate energy transit in accordance with the principle of freedom of transit and not to interrupt or reduce established energy transit flows.

These are all principles in the Energy Charter Treaty of which Japan is a member, Russia has accepted but not signed, and to which China, the U.S., and South Korea are observers.[93] This is not to say that the principles can be agreed upon for regional energy cooperation in Northeast Asia, only that a few of the actors in the region are likely to argue that they should be applicable, if and when cooperation is discussed.

[93] "Energy Charter: Members and Observers," available at: http://www.encharter.org/index.php2.id=61 (accessed October 2, 2008)

Conclusions

While North Korea is an emerging economy, China is a country with an economy that has already more than emerged. However, some circles in China still claim the right for China to be treated as an emerging economy, especially when it comes to trade in oil and gas – and certainly China has special problems with its supply of raw materials, which are caused by its own position as a "recently emerged economy." That problem has to be addressed, but should it be done in the same way as for North Korea? The answer is no. North Korea's interests will not be served by being allowed to use all its means of power to secure its access to oil and gas – because its means of power are very limited outside its own borders. It simply needs aid to escape from the desperate situation in which it finds itself, not opportunities to yield effects of its power.

China, on the other hand, is a powerful nation, and for many Chinese it may seem natural enough to use all its means of power that are available to secure its supply of raw energy materials. However, on the world market it is meeting growing competition from India, which is also likely to use all its available means of power and which has needs for energy that are almost as desperate as those of North Korea. In addition to that, China is already encountering hard competition from the U.S., which is experiencing a rapidly growing demand for imported oil and gas. And the U.S. is a very powerful country which until now has applied the principles of the ECT, but is not likely to continue doing so, especially if other powerful actors on the world market like the European Union and Japan should feel free or tempted to discard these principles.

So far, the situation is more or less under control in North East Asia, which is a region where a powerful China and a powerful Japan have been able to avoid the negative consequences of unrestricted competition and instead have been able to establish Confidence Building Measures in the field of energy. Russia has rarely used oil and gas as a political weapon in this region,

thus far. Another member in the six-party talks is the U.S., one of most important factors for stability in the region, but also a nation which desperately needs more oil and gas. North Korea meanwhile shares the distinction of being the root cause of the problems which have made the talks necessary. South Korea and Japan have potentially great interest in supply of energy from Russia via North Korea.

The rest of the world would find itself in a problematic situation if some of the most important actors on the world market were to abandon the free market principles in trade over oil and gas. There is a danger that this will happen in Asia, unless some principles are explicitly agreed upon and codified in agreed statements.

Energy should not wait to be discussed until nuclear and related issues are solved. Energy talks over principles in North East Asia should be initiated in a serious way now, not later.

If no principles for trade in oil and gas and electricity are agreed upon in Asia, market conditions will be characterized by competition between states and/or NOCs. China (and India) are powerful and potentially rich and their NOCs are likely to be successful, since they are backed by their governments. They will not only be successful in their own region but on the global markets. This will inevitably lead to less resources in the hands of the traditional IOCs on which the Western countries, including Europe, depend for their supply of oil and gas.

In that situation, it seems difficult to imagine any other long term development than that of NOCs taking over the roles of IOCs in Western countries, and that the global markets will be dominated by NOCs supported by governments. This also means that governments will become directly involved in a race for oil and gas, resulting in the risk of potential international conflicts becoming more frequent than what we have become accustomed to during the post WWII period.

About the Author

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