Oil Companies and the EU's External Energy Policies

Richard Youngs

Most recent debate on energy security has focused on issues relating to climate change, European Union member states' internal energy mixes, and reactions to the Commission's 'unbundling' proposals. It is well known that European energy companies have been strongly engaged on these issues, in many cases speaking out vigorously and critically against EU policy proposals. The business voice was heard loud and clear in response to the Commission's January 2008 so-called '20/20/20 by 2020' package.

But there is another dimension to energy security that has so far been of much lower profile, and in relation to which European oil companies' engagement has been less than systematic, namely the foreign policy dimension. During the last three or four years, European governments have argued that energy security requires a more proactive and unified external dimension, and that energy must be incorporated fully into the EU's Common Foreign and Security Policy (CFSP).

In this important respect, two key challenges can be identified for European oil and gas companies. First, the private sector's level of commitment to and engagement on the foreign policy dimension remain questionable, and need to be ratcheted up. Second, oil companies still tend to see foreign policy choices in highly realpolitik terms that actually militate against their own need for more transparent and open systems of governance in producer states. This essay argues that while oil companies are most often thought to eschew any political issues in their relations with producer states, a more political focus, through a united CFSP, would be in their own enlightened self-interest.

European multinationals have been slow to engage with the new foreign policy dimension of energy security. Their main focus from the mid-1990s has been on internal market liberalisation and environmental issues. The foreign policy dimensions of energy security have not received systematic at-

Richard Youngs, Director of the Democratization Programme, Fride.

tention; the private sector has reacted to rather than led efforts to incorporate energy questions more fully into the CFSP.

Towards a Common Foreign Policy Dimension?

The European business community tentatively started to focus on the external dimension of energy security only as energy prices began to hit record highs and after reflection was needed in reaction to the Commission's 2006 Green Paper. Prior to that, energy security concerns had been equated to internal market issues and specific trade-related instruments – the main focus of lobbying had been on the importance for European businesses of tackling the practice of dual pricing in producer states.

Formal forums incorporating the private sector into CFSP energy security deliberations are limited in nature. At the EU there is nothing comparable to the US-UK Energy Dialogue created in 2002, aimed at "bringing together the separate strands of international energy policy and foreign policy" and incorporating companies into this process of enhancing political stability for investment.

European oil companies' inclusion and influence over EU foreign policy has certainly been weaker than that enjoyed by their US counterparts over US strategic policy. Chevron Texaco, Exxon Mobil and Enron all had significant input into the energy review carried out by the Bush administration.[1] The tightened relationship between the oil majors and the US government witnessed under the Bush administration embedded the notion of energy policy resting on a strategic partnership: in the Persian Gulf, the Caspian and West Africa US multinationals would back the government's geostrategic policies, while the administration would in return directly back the companies' interests. Again, nothing of comparable significance has taken shape in influencing CFSP. This is not to suggest that the US model is a good one to emulate, but the relative disconnect between companies and the CFSP is striking and would hardly seem to contribute to overall European interests.

European oil companies have begun rhetorically to support a more energy-oriented CFSP, built around a more holistic understanding of security. One company representative, for example, argues that: "Energy security can be enhanced by actions taken within Europe but fundamentally European energy security is a matter of foreign policy". Both the private sector and European governments need to understand that the type of 'security' required for energy security, "extends to the whole process of development [in producer states] and how it is advanced".[2]

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1. Michael Klare, Blood and Oil, London, Penguin, 2004, p. 35.
2. Nick Butler, 'European Energy Security', presentation at the International Institute for Strategic Studies, Geneva, 17 September 2005, http://www.bp.com/genericarticle.do?categoyId=98&contentId=7010497

In theory, executives say they recognize the need for deeper engagement on the more political aspects of energy security in Russia, the Middle East, the Caspian and Africa. They argue that this involvement needs to go well beyond the kind of technical dialogues that the EU has to date focused on initiating. Few in the private sector view the results of such dialogues as positive or particularly relevant. The umbrella organisation, OGP, has called for a more coherent and strategic EU approach to energy security.

Indeed, in some cases companies have been well ahead of governments in pressing to diversify into new areas in a more geopolitical fashion. By the early 2000s, Total was spending 30 per cent of its global exploration and production budget in Africa, and lamenting the lack of an EU geopolitical strategy in the continent. Central Asia provides a similar example, with several European companies that entered this high-risk frontier area in the 1990s complaining at how that have struggled to interest EU ministers and diplomats in the region.

But in practice, European energy companies – perhaps predictably – have espoused EU unity in external energy policy while fighting to retain their own national room for manoeuvre. Generating something akin to a Prisoners' Dilemma, European energy companies appear to desire a unified EU energy strategy but free manoeuvrability until that becomes an imminent prospect. Indeed, spokesmen admit to a certain 'schizophrenia' on the part of private sector: firms want EU-level foreign policy muscle to back them up much more than at present, but at the same time complain strongly over specific issues where the national room for manoeuvre is constrained by European level policies.

The European oil and gas sector has consequently not been a strong supporter of the Commission's efforts to develop a foreign policy dimension based around market and governance rules. The Commission and some member state governments have seen the incipient energy-focused CFSP as being about making both European and producer state firms adhere to market rules and preventing them from sewing up the market in cosy deals that – despite all the apparent tensions with producer states' companies – both are reasonably content with. According to some critics, it is in this sense that the interests of European oil majors are diverging from those of overall EU energy security.[3]

Good Governance as Self-Interest?

Of course, one of the main charges against MNCs is that their search for new oil and gas contracts undermines the scope for EU human rights policies.

3. Friedemann Müller, *Energy Security: Demands imposed on German and European foreign policy by a changed configuration in the world energy market*, SWP Research Paper, January 2007, p. 18.

The EU has promised that its new approach to energy security is designed to support improvements in governance, democracy and human rights. In practice, criticism continues against oil companies for having failed to move beyond a much more realpolitik approach.

In many authoritarian producer states, MNCs in the oil sector are still favoured with fast-track procedures outside domestic governance frameworks. Oil executives' list of states in which they judge the investment climate to have improved over the 2000s include countries with clear democratic limitations: Angola, Libya, Azerbaijan, Kazakhstan and Egypt.

In the Middle East, many investors harbour negative concerns over possible political liberalisation, expressing a mostly unfavourable view towards the prospects of Islamists winning power. Many think reform would be particularly destabilising in Saudi Arabia. Some insist that hostile conditions do not perturb oil companies, whatever their rhetoric to the contrary, as they simply increase margins and guarantees within their contracts to compensate for more politically difficult operating environments. Oil is still widely seen as the archetypal enclave, immune to domestic political problems.

EU's approach to energy security supports: governance, democray and human rights

If anything, the increasing tightness of international energy markets has reinforced the search for and magnitude of 'first mover' advantages, the rents obtained by being first into politically risky markets. The margin for manoeuvre is also squeezed by competition from NOCs, which in many places are now far more equipped to begin actually managing local resources.[4]

The rise of the Corporate Social Responsibility (CSR) agenda is commonly criticised as being about no more than improving companies' image and reducing their "reputational costs", having little impact on the way oil giants operate in conflict zones.[5] And the EITI remains narrow in scope, focusing on auditing company payments to governments rather than on broader corruption problems.

But it has become increasingly clear that relations based on personal patronage, in contexts of weak institutional governance, can create significant problems for international investors.

Oil executives commonly lament that the 'resource nationalism' associated with non-democratic regimes is a major obstacle to the desired expansion of investment. Several European oil companies saw their interests

4. Valérie Marcel, *Investment in Middle East Oil: Who Needs Whom?*, Chatham House Report, February 2006, p. 6

5. Global Witness, *Oil and Mining in Violent Places: Why Voluntary Codes for Companies Don't Guarantee Human Rights*, October 2007.

seriously effected by the resource nationalism that helped sustained Hugo Chávez's Bolivarian revolution. After one round of confiscations, Chávez hoisted the Venezuelan flag over fields until then operated by Eni and Total.[6]

Some of the countries with the largest remaining energy reserves are reluctant to open up to investors, in part out of fear over the impact that a general process of liberalisation would have on the control exerted by the incumbent regime.

In most producer states international oil companies are not given adequate incentives for secure, long term investment. Countries such as Iran and Saudi Arabia (in its subsequently diluted National Gas Initiative) were unable to attract bids from a large number of big players. Capital needs have been sacrificed to governments' budgetary needs, as non-democratic regimes rely heavily on populist distribution of oil revenues. And, elsewhere in an increasingly unstable Middle East, security costs are over 10 per cent of operating costs in Algeria.

The highest profile problems have, of course, occurred in Russia, with Shell and BP famously subjected to de facto nationalisation of two of their respective operations. Of course, despite the high profile 'problematic' cases, a plethora of bilateral deals have been accumulated between European companies and Gazprom – those signed by ENI and E.ON being of particularly notable reach. But these deals have required hefty quid pro quos, in the shape of downstream access ceded to Gazprom in European national markets, in lieu of an open and objective rule of law prevailing in Russia.

MNC representatives in Central Asia and the Caspian suggest that European companies' interest in the region has reached a plateau as more assertive regimes reopen contract conditions from the mid-1990s to insist on much lower premiums. Turkmenistan remains virtually impenetrable, except for small exploratory investments by independents such as Burren Energy. Total made strenuous efforts to sign a deal after president Niyazov's death, but to little avail as of late 2007. In Kazakhstan, Repsol complained that arbitrary rule making delayed its entry into the country, which was only secured at the end of 2006 after many years of negotiation and political procrastination.[7] And the Kazakh government is now seeking to reopen conditions relating to the Eni-led consortium developing the Kashagan field.

While in Nigeria much is (rightly) written on the harm done by Shell and other companies to local communities, the country's post-1999 'low intensity' democracy has itself served to dissuade more significant rises in European investment. Multinationals complain at being squeezed between, on the one hand, an ever-rising tax take from the federal government and, on the other hand, the de facto need to compensate for the lack of effective law

6. *Financial Times*, 4 May 2006.
7. *El País Negocios*, 29 April 2007, p.16

and order provision by paying for local security services, which often amount to little more than old fashion protection money.[8] In 2004 Shell's own consultants argued that if the next presidential elections were not more democratic and again fostered conflict, the company would have to abandon on-shore production.[9] Trying to placate opposition through development projects has failed to assuage, but has rather simply dragged Shell and other companies into acrimonious conflicts between different regions and villages and ethnic groups over who should receive such funds.

In sum

European oil companies should attach greater priority to the systematic incorporation of energy questions into CFSP. And they should support a CFSP approach to energy security that is based on enhancing governance standards in producer states. At present, debates over internal market liberalization and renewables have captured the agenda in a way that the foreign policy challenges of energy security have failed to do within the private sector. But in the long term, the geopolitics of energy will become increasingly important, even if the EU meets all its targets on emissions, renewables and energy efficiency. Companies need to engage on the foreign policy dimension, rather than belittle its value as often happens at present. And while short-term advantage can be gained by undercutting European competitors with bilateral deals that undermine the EU's own strictures on democratic governance, in the long term such options will work against the interest of European companies, already squeezed by rising NOCs.

8. International Crisis Group, Fuelling the Niger Delta Crisis, 2006, p. 10
9. African Confidential, 46/23, 18 November 2005.