National Oil Companies

What role can they/should they play in an age of liberalized markets, globalization?

Workshop on The Role of National Oil Companies in International Energy Markets

Hosted by The Baker Institute Energy Forum and The Institute for Energy, Law & Enterprise

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Outline

- Supply constraints and the revived attention to NOCs
- The dual problem:
  - Politicization/zero-sum relations
  - The prisoner's dilemma on a global scale - everyone can potentially lose
- The historical context: a century of experience
  - War
  - Revolution
  - Severe Structural Adjustment
- The challenges for public policy
  - How to break the 'oil curse' syndrome
  - Finding win-win solutions without impinging on sovereign property rights preferences

Three Fundamental Factors

The recent revival of interest in NOCs

- For nearly a generation following the decline and collapse in oil prices, NOC's were attacked as outmoded fossils, many were privatized
  - Soft markets required them to be more commercial, shed tasks imposed on them
- The emergence of supply constraints a half decade ago focussed attention again on the NOCs:
  - The producers' control over 80%+ of reserves
  - The emerging importers (China especially) feel constrained by existing "rules of the game" also led to their revival

Three critical reminders:

1. The world is split: there is no permanent global consensus on the roles of the public and private management/control in the energy sector - either among or within nations
2. The importance of state-owned enterprise reflects numerous exogenous factors, but especially important is the structure of the market

   Supply and demand balance for the commodity, itself

   Supply and demand balance for inventories of oil in the ground and for acreage and exploration rights

   - **When markets are soft, NOC's are important for one class of producers - those especially dependent on oil revenues and not for NOCs of importers, or producers not hooked on oil (1982-1999)**
   - **When markets are tight , their importance rises for importers, those who want access to their reserves (1970's, now)**

3 - Politics Versus the Market

3. Reminder that the very existence of NOC's reflects view that energy markets (especially oil) are inefficient, unjust, creating unfair burden of adjustment, or a politically unacceptable distribution of benefits

   Political intervention is required in order to: 1) right the wrong, or 2) to create a more even playing field, or 3) to force a better distribution of benefits, or 4) to shift the burden of adjustment on someone else, or 5) to enhance other state objectives, or all five of these

   Hence, NOCs became agents of the state designed to achieve a clear set of objectives that the market could not achieve or whose achievement the market impeded

   The main objectives embodied in NOC's thus serve essentially redistributive objectives, which imply that someone gains at someone else's expense

Two Critical Problems

The dual problem associated with national oil companies

- There is no doubt that NOCs have facilitated the achievement of frequently extraordinary benefits for their societies, including the acceleration of technology transfer, development of human capital, the transfer of income and wealth from others to the sovereign shareholder
- Even so, there are two clear problems:
  1. **The fact that NOCs are created to achieve objectives that the market failed to achieve embeds the institution in a non zero-sum world: either its gains come absolutely at the expense of someone else's loss; or its gains are relatively greater than someone else's. This creates major tensions in tight markets, with potentially severe side effects (arms sales, alliances)**
  2. **From a global perspective, there is little doubt that the injection of politics in this market leaves everyone worse off than they otherwise might be. Whether this is inevitable is an open question, but it is historically the case in tight markets**

Some areas of inquiry, some examples

NOCs in oil importing countries

- Blossom in the 1970s, when upstream assets of majors were nationalized, creating a new set of major players in the NOCs, especially in Opec
- Cut off from their supplies, the IOC's in turn ended their 3rd party supply obligations (Japan, most of the emerging markets)
- The new NOC's (or newly independent refiners) bid up the price of oil as new players each needed to replicate the old inventory systems; must of the price increases of 1973-74 and 1978-80 stem from wanton inventory builds, not crude shortages
- Once high prices led to a drop in demand, inventories became expensive and were released: 1982-85 - 1 mmb/d of inventories competed head to head with Opec supplies, until 1 billion bbls of surplus stocks were unloaded, bringing down prices
- Each acting in its own interests resulted in a system in which no one in the end benefited

Other areas of inquiry

The public policy challenge of the “oil curse”

- It is exceedingly hard for a country dependent on oil to attain sustainable development goals
- Substantial progress was being made in some cases using the leverage of the international financial institutions, especially in West Africa
- That leverage is being lost in a period of high prices and high income
- If the period of tightness lasts a long time, the oil curse will likely still be inescapable
- The public policy issue is how can the role of the national oil company be tailored to ending the oil curse ? Does it take a special combination of factors, including the emergence of participatory government? Can Algeria be a model of the future?

Why this is relevant - two critical issues in today's world

- Access to 80- to 90% of global oil resources are dominated by the state and state companies

  How can win-win solutions be molded leaving all parties better off ?

- The rise of China (and other importers), combined with their market size and clout as well as their emphasis on non-economic criteria guiding oil trade and investment, plus the lingering fear of what could happen in a very tight market if one or more producers become failed states, is creating potential trade and other tensions and to behavior like what happened in the 1970s, leaving all buyers worse off.

  How can cooperative solutions be structured leaving all parties better off ?

- Russia plays a critical role, because of the size of its resource base and the importance of the resources to the integrity of the state and the government's domestic and international power and influence

  How can others help create non zero-sum solutions here as well ?

NOCs - A historical perspective

National oil companies are part of fundamental 20th century history

NOCs arose from global situations of massive importance: these are relevant to the political culture of the world in the 21st century

1. WAR: Both World War I and World War II and the critical need to access oil resources
2. REVOLUTION: Starting with the Bolshevik Revolution, the world perspective of Marxism infuses the culture of national oil companies
3. MASSIVE ECONOMIC STRUCTURAL ADJUSTMENT

A brief discussion and understanding of each of these is essential

1. War and 'High Politics'

- The familiar history of Anglo-Persian (BP) smacks of other NOC's in oil importing countries in more recent days
- The rationale is obvious: the state's involvement in access to oil resources is critical to its having great power status; at a less 'cosmic' level, it is critical to its role in the domestic economy
- Impacted all of Europe - from Britain (BP) to France (Total, Elf) to Italy (ENI) to the other economies
- A cursory reading of Yergin's *The Prize* brings to the fore the state's role in guaranteeing oil supplies (Germany's access to Russia and Japan's to Indonesia as key elements of World War II, partly as responses to outside imposed oil embargoes) throughout the last 100 years

2. Revolution

- It is impossible to overstate the role of revolution on the political culture of national oil companies
- Starts with 1905 and the Bolshevik-led strike at the Baku production and refining center, then the world's largest such center (50% of global supply, refining)
- Focus of Revolution is on a sector dominated by foreigners (the bankers - Rothschilds and Nobels; the bad companies - Standard Oil and Shell)
- Marxian analysis becomes salient to the culture of NOCs and provided a cogent explanation, which took immediate hold in Latin America (Argentina -world's earliest NOC, Venezuela, Mexico and the revolution in 1938)

Critical elements of Marxian rhetoric

- Oil companies exploit and impoverish - the law of uneven development
- The power of international capital versus the power of the state (company turnover versus country GDP) requires countervailing institutions
- Foreign companies are Trojan Horses, induce workers to be more loyal to the company than to the state
- Huge flow of funds reinforces desire to recast rentier profits into state revenues
- There is not much of a gap between the rhetoric of the Bolshevik Revolution, the nationalization in Russia and Mexico, the creation of producer NOCs in the '60's and '70s and Hugo Chavez
- Revolutionary rhetoric and perspective are critical elements of the political culture of all major oil producers where energy dominates the economy, from Algeria to Malaysia, Mexico to Russia; makes change difficult (Algeria, Kuwait today)

3. Severe structural change

- NOCs are instruments of the state designed to shift the burden of adjustment from the global economy or from other factors onto other societies
- OPEC - from its origins through the critical 1998-2000 period: create and maintain strong state companies that can act to defend the interests of the state and state revenues against the outside world; push the burden of adjustment onto consumers (a key motivation in 1998-2000 - what did the US do for us then?)
- Maintaining state monopoly or control over access to resources is important; why share the revenues with outside companies?
- Perpetuates the view that the market, foreign oil companies, speculators are the enemy, depriving the state of its ability to enhance the value of its assets; the NOCs are the best defense against these powerful enemies and the structural change they can bring

Some concluding issues

Micro and Macro Views

- Understanding NOCs and adopting appropriate policy responses involves not simply an appropriate micro view as to what drives these companies and their shareholders
- What is also required is a macro perspective and macro lessons
- The common research protocol is essential, but so too is a look at the subject from a system orientation

One challenge is to look ahead 10 years

- If the petroleum sector is in a period of sustained expansion, with higher sustained prices, what can be done to prevent another 1985?
- How can the oil curse syndrome be broken, reversed? - a subject of important not just to Saudi Arabia, Iraq, Iran and Nigeria, but to the whole world
- How can we look at what might have occurred if different paths had been taken (why is KPC the same size now as it was 25 years ago, while BP is 10X bigger? Could KPC have brought better returns to its shareholders?)
- How can we review experiments being undertaken today for example in Algeria, with its bold new Hydrocarbon Law - how to preserve and enhance the NOC and make room for domestic and international win-win situations with foreign partners; how to reinforce and encourage incipient democratic institutions and build on the positive elements associated with a popular institution and its participation in a popular, successful, South-South organization (OPEC)

More on Breaking the Resource Curse

- How can foreign institutions (IFI's like the World Bank and Regional Banks, foreign governments) play a role in ending abuses
  - Interesting history of this in the 1980s, as in de-nationalizing YPF after the government used it as the borrower of last resort and thereby forced it into bankruptcy (building roads, the Buenos Aires airport)
  - How to pare down NOC functions to commercial activities and reap the benefits thereof (Mexico's Pemex as the owner of a huge hospital system, telephone company)
- There is a clear role here for the NOC in the fostering of transparency, democracy and sustainable development

Another systemic challenge is how to create win-win solutions internationally

- The energy sector is on the precipice of another round of severe neo-mercantilism, with the state using the NOC as an instrument of foreign and domestic policy to achieve specific non energy-policy goals
- There is an enormous challenge in finding ways to combat the zero-sum politics latent in today's high price environment (assuming prices might reach even much higher levels) without impinging upon a nation's sovereign right to manage the sector as it sees fit

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A PROFILE

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