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NATO Review

World financial crisis: what it means for security

[Contents [Past issues [Schedule 2009 [Contributors [In the next issue

LANGUAGE

English

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Energy and the crisis - more or less secure?

The crisis in the financial world could open up new ways of working in the energy world, argue Dr Heiko Borchert and Karina Forster. Here they look at the impact on energy companies and countries and how the crisis may force them to change.

The impact of the financial crisis on energy security could be about much more than just the price of oil

At first sight the current crisis is about financial and economic failures. But much more is at stake.

The transatlantic community has based its international leadership role on the belief that private sector self-regulation yields superior economic benefits. The current crisis has undermined this assumption.

So the current economic crisis is also a political crisis, which translates into a global leadership gap. Structural instability will be the main outcome of this power wrangling. Nowhere is this more obvious than in the energy domain.

> Resource-rich countries continue to use their assets to advance their own interests, broaden their areas of influence and create alliances with like-minded partners.

The world's dependence on energy supply continues to grow, making energy security a strategic priority. The current economic crisis may have driven down prices and slowed economic growth. But this is nothing more than a pause.

Resource-rich countries continue to use their assets to advance their own interests, broaden their areas of influence and create alliances with like-minded partners. Similarly, energy-transiting and -importing countries are also attempting to leverage their positions. These forces are about to change the nature of international affairs.

Reuters

Resource rich countries and the financial crisis: a changing landscape?

So far, the transatlantic community has not found convincing answers to these challenges. This is unfortunate.

We see the following likely impacts of the financial crisis on the energy sector.

The impact on energy suppliers

Russia, Iran and Venezuela all seem to have been hit hard by the current crisis. Some observers believe that 'energy nationalism' has been tempered. Others argue that whatever price concessions such countries may accept will be short-term and tactical in nature. In addition, several analyses point to the growing number of unemployed migrant workers due to investment cut-backs, particularly in the energy sector. This could become a source of social unrest in Central Asia and certain Gulf states.

A recent analysis by Stratfor suggests that foreigners make up 69% of the population of Kuwait (whose share of world oil reserve is 8%) and 80% in Qatar (whose share of world gas reserves is

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14%). In Saudi Arabia, by contrast, foreigners account for only 25% of the population. Furthermore, the Saudi Arabian Monetary Agency invested more cautiously than other Gulf state sovereign wealth funds, providing it with greater financial security.

The consequences for energy companies

The crisis is having mixed consequences for energy companies. On the one hand, increasing capital costs make investments more difficult. This is a problem for the renewable energy industry because investment costs are higher than in other energy sectors. Higher capital costs are also a problem for transmission and pipeline companies, which need long-term financing for infrastructures, and oilfield services companies. On the other hand, energy-supplying countries tend to become more open towards multinational companies, as they need partners to help shoulder the high costs of energy projects. This could open new opportunities for cooperation.

For strategic and environmental reasons, the world must reduce its dependence on fossil fuels. But lower investment could slow the development of renewable energy technologies

Cash creates political leeway

Some energy producers have accumulated significant foreign exchange reserves, giving them more political leeway. In what could be seen as a sign of changing times, US Secretary of State Hillary Clinton assured China in February 2009 that Chinese holdings of US treasury securities, which amounted to $740 billion at the end of January 2009, remained a valuable investment. In addition, cash-strapped energy companies seem more willing to compromise. In a February 2009 deal, China reportedly managed to purchase crude oil from Russian Rosneft at about one-third of the common market price.

Climate change policy under pressure

It is an open question whether the current momentum for climate change policies will last. For strategic and environmental reasons, the world must reduce its dependence on fossil fuels. But lower investment could slow the development of renewable energy technologies. The high costs of these investments may result in lower carbon dioxide abatement goals. If current goals remain in place, producers may transfer carbon dioxide-intensive production processes to regions with lower standards. This could improve the carbon dioxide balance of one region at the expense of another, sparking diplomatic tensions. Finally, subsidies for renewable energies could come under pressure. They have already led to trade disputes between the United States and the European Union (EU).

Growing role of the state

The state's role may grow as a direct outcome of the financial crisis. Governments will act as financers of energy infrastructure investments. Governments may also re-enter the energy sector as active players, either via state-owned companies or as shareholders. Finally, companies could turn to governments to build new energy infrastructures such as carbon dioxide storage facilities and pipelines.

Reuters

The financial crisis has challenged energy suppliers, companies - and customers

Changing regulatory systems

Self-regulation seems to have failed in the financial domain. This will have major consequences for multinational energy companies that prefer government non-interference. Government support will likely come with strings attached. One major question is whether governments will continue to guarantee the preferential regulatory treatment of renewable energies.

In addition, Michael Levi of the Council on Foreign Relations recently observed that 'tax credits have suddenly become all but useless as struggling companies find themselves with little if any tax burden to write off.' This could entail a shift from incentive-based regulation to more traditional regulation and government spending.

What to do?

These variables mean that guaranteeing energy security has become more difficult. In addition, recent events have shown that energy security has the potential to drive a wedge between EU member states, and between them and the United States. Transatlantic partners should do their utmost to avoid a division over energy issues.

The current economic crises creates opportunities for cooperation with energy producers

In fact, the current economic crises creates opportunities for cooperation with energy producers. Scientific and technological cooperation with energy producers could boost energy efficiency and help protect the climate.

Time for concrete action

For too long members of the transatlantic community have projected their regulatory preferences on other countries. A strategic dialogue on energy security must more actively engage with the Istanbul Cooperation Initiative, the Gulf Cooperation Council, the International Energy Forum and the Organisation of the Petroleum Exporting Countries. These institutions should stimulate dialogue on how economic prosperity, energy policy, regional stability, and environmental goals could be combined.

In addition, there is a need to advance direct engagements with national oil and gas companies, which could serve as spearheads to improve energy efficiency in energy producing countries and to advance the safety and security of energy infrastructures.

Together with energy producers and other key energy consumers, a “Global Compact for Sustainable Energy Infrastructure Investments” could be launched.

This initiative should bring together multinational and state-owned energy companies, investment banks, international financial institutions, sovereign wealth funds and technology companies. This Compact would analyse the mix of energy technologies most suitable to meet regional economic development plans and environmental goals, prioritise infrastructure investment projects, and stimulate multinational research and development initiatives.

The safety and security of energy infrastructures is of key importance to all stakeholders involved in the global energy supply chain.

Two issues are of key importance: First, the external dimension of infrastructure protection, i.e. the dependence on infrastructures hosted in third countries, which should receive more attention. Joint risk analyses should be conducted and best practices on security measures could be exchanged. Second, maritime security is vital to secure energy transports at sea. This creates opportunities for new international joint ventures to provide security of port facilities and strategic sea lanes. And these are areas which directly impact NATO.

Dr Heiko Borchert and Karina Forster of IPA Berlin have previously written studies for Germany’s Ministry of Defence, Switzerland’s Department of Foreign Affairs and the European Commission, focusing largely on energy security.