

POLITICAL VS ECONOMIC CONSIDERATIONS BEHIND THE OIL & GAS EXPORT DECISIONS: WHICH PREVAIL?

“What my involvement with international energy relations since January 2012 has taught me”...

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PURPOSE OF THE LECTURE

Make distinctions among **different** “energy environments” around the Globe. A case-specific approach seems more useful than generalizations
e.g. Russia is *not* Israel, Equinor is *not* Aramco

Understand the significance of the breaking news,
e.g. “*this became a PCI*” or “*we signed an IGA*”

Two quite famous scholars (I) USA



Notable scholars (II) Europe



Some proponents of the “political” essence of decision

Ambassador Dr T.Babali (*Caspian Energy Diplomacy, 2003*)

- “The purpose (Ph.D Thesis – Un. Houston) is to identify the principal factors in selecting export routes for the Caspian energy resources”
- “The objective is to develop a model in order to understand the outcome of the policies of the major actors, governments and companies, in the development and marketing of the resources”
- “Transnational companies are treated as actors equal to nation states”
- “My hypothesis is that political factors are dominant in the region (...) the political process is more important than economics in determining which pipeline is to be built ”

B.Shaffer (Energy Politics, 2009)

- *“Energy and politics are inseparable”, as “energy security is an integral part of the foreign and national security policy”. This is the well-known energy-security nexus, accepted by everyone today.*
- *“Political factors significantly affect the commercial viability of energy infrastructure projects” (investment risk). This also seems to be true. But then Dr. Shaffer goes one step forward:*
- *“States, in choosing routes to export their commodities, naturally consider and promote the political ramifications of the various route options”*
- *“Decisions on natural gas export projects are likely to be affected by political considerations”*
- *Shaffer’s view is a generalization on a global scale of Babali’s main argument about the Caspian. As an example she uses the BTC oil pipeline: “It strongly illustrates that major energy infrastructure projects inherently involve political considerations”. **FYI, oil pipelines are much cheaper to build than gas pipelines and they also carry a commodity of extremely higher specific value / per m3***

Energy Geopolitics, a fashionable discourse

- Political scientists & international relations scholars, like the above and myself, *dominate* the discussion about energy infrastructure projects, despite the need for an inter-disciplinary approach (as Dr Shaffer acknowledges).
- In addition, the leading “paradigm” in international relations remains political realism, with an emphasis on geopolitics i.e. projecting power over a certain geographical sphere Therefore, energy (geo-) politics nowadays dwarfs energy (geo-) economics. **But how about pipeline and LNG economics? Exportable commodities, like oil and gas, must bring some profit to the producers (monetize) / or not?**
- The appeal of geopolitics is irresistible to many, because Russia has been somehow playing this game since 2000, in order to regain its Great Power status. V.Putin’s Ph.D. Thesis (1997), entitled “*The Strategic Planning of Regional Resources under the Formation of Market Relation*” is often cited. Energy diplomacy is seen as an integral part of Russian foreign policy

WHO ARE THE DECISION-MAKERS?

- **States** cannot finance and execute investment projects themselves. In effect, decisions are the output of a rather complex interaction between different kinds of “actors” such as: a) nation-states (governments), b) international organizations c) NOCs, d) IOCs and e) financing institutions, from private banks to Sovereign Wealth Funds
- The decision-making environment looks case-specific depending on certain **variables** like 1. How much is at stake for the exporter 2. Prevailing doctrine (market economy with IOCs or “resource nationalism” with NOCs) 3. Type of legal agreement 4. Size of the exporter and 5. International Prices.
- IOCs like the so-called “Super-majors” basically care about their profit maximization, i.e. driven by commercial considerations. A pipeline or LNG plant is just an investment / ROI is needed in order to make sense.

- NOCs (*the children of resource nationalism*) control the vast majority of oil & gas reserves (close to 90%) as well as production (75%) today.

They can be a very useful tool of foreign policy by applying, to some extent, **non-commercial** or strategic criteria. However, they also have some limitations: a) They must provide constant “**rent**” to the state budget (rentier states), b) they must secure “upstream” investment in order to maintain the levels of production (which they don’t see Russia) and c) they face intense competition from IOCs. In the long-term, their performance will have to increase to remain competitive, so commercial criteria exist. Even their monopoly status or the dominant market position is now being challenged, like the decision by Russia since 2013 about (partial) liberalization of gas exports.

Different types of NOCs exist in different countries: Norway's **Equinor**, where the Board enjoys a degree of independence, is not like **Gazprom** or Aramco! The “revolving doors” management system (state officials and company managers) does not apply to all NOCs.

HOW MUCH IS AT STAKE AND HOW MUCH (\$\$\$) CAN WE AFFORD (TO LOSE...) IN ORDER TO ACHIEVE IT?

- States pursue several goals, including political ones. Security has always been paramount. There are several degrees of importance a state can attach to a particular export route of hydrocarbons, ranging from high to low. How much will the route of choice affect our sovereignty? The highest the stakes are, the more political or “strategic” the choice can be
- When the economic competition/evaluation of various projects is “neck to neck”, there is more room for politics. This is not the case, however, when “*there is a significant commercial difference between the two competing projects*” (BP’s Gordon Birrel on TAP’s victory over Nabucco West, July 2013). Still, both these pipelines led to the **West** and not Russia, despite the 2010 offer for a much cheaper alternative

<https://www.iai.it/sites/default/files/iaiwpl327.pdf>

Azerbaijan and BTC or the TAP-TANAP combo: For a small, land-locked country which exports two commodities (94%), being a “hostage” of another country would simply be a non-option, no matter what the cost is. Goal: to achieve -real- independence from its two former masters. *“We have never said it’s just about business. It’s about these countries gaining a greater measure of autonomy”* (Amb. S.Mann).

Russia and South Stream: Mostly political project, to deprive Ukraine of income after 2019 and to kill Nabucco (also to give contracts to the steel pipe industry). Goal: to project power over “Near Abroad”, but not an absolute “must” in its grandiose form. In 2007, it seemed affordable. At a price tag of \$ 45 billion (2014 estimate), it was not. Now Russia exports to EU via the Turkish Stream substitute / 1 string instead of 3


Israel and Tamar-Leviathan exports: Israeli economy is not based on energy and Israeli national security policy does not need the “tool” of gas exports to be effective. Still, an export license will have to be given by the state (“veto power”). No Israeli government would give such a license if the receiving or even the transit state was at odds with Israel.

THE REAL IMPORTANCE OF IGAs

- States often sign bilateral or multilateral IGAs of public international law in order to promote energy projects such as pipelines, eg the Nabucco IGA (2009), the TANAP IGA (2012) the TAP IGA (2013) and the East Med IGA (2020). Proponents of the “political nature” of international energy relations overestimate the role of IGAs, together, of course, with political leaders.
- IGAs are necessary conditions for implementation, as no international project can be implemented without state bureaucratic support such as permits. Still, they are not sufficient! We have seen many IGAs for “might-have-been” pipelines...
- By signing an IGA a state merely decides to endorse a project originally conceived and initiated by companies, often private ones, which are the entities responsible to fund and build it. The TAP IGA was signed ten years after the project was launched by the Swiss Axpo (2003)! By that time, however, the project had gained such momentum, that even Italy and Greece, formerly supporters of the ITGI pipeline, were allured. It was the business consortium of TAP (not any political entity) which did such a great job so that, by the early 2010s, they had a front-runner!

CASE STUDY: GR, IGAs & THE SOUTHERN GAS CORRIDOR

- All consecutive Greek governments since 2000 expressed their support for receiving and transiting gas from the Caspian region, despite the fact that gas imports from Russia had started only in 1996 and that the main pipeline was not operational until 1999.
- In 2003, when the TAP project was initiated, Greece ignored it, being extremely optimistic about the merit of the rival **ITGI** project supported by its national gas company, DEPA. The case here seems a reversal of roles between the government and the company: “*What is good for the company, is good for the country*”! Italy was also supporting ITGI, because of its own company involved. In 2005, a Greece-Italy IGA was signed to build the offshore section under the Adriatic, **IGI Poseidon**. A trilateral IGA with the inclusion of Turkey followed in 2007. Only Albania was supporting TAP, which lacked an IGA for 10 years!



Institutional support for ITGI made Greek analysts and policy-makers regard TAP as an underdog, despite the addition (2008) of Statoil and EGL Group, more powerful business entities than DEPA and Edison. No serious thought of merging TAP with ITGI ever occurred. In 2010, MFA Deputy Minister stood cold to the Norwegian Ambassador. By signing the South Stream IGA with Russia in 2008, a **strategic disorientation** took place. Even before the country risk issue, it was difficult for small companies such as DEPA and DESFA to finance both rival projects. For certain circles, this would have been no problem at all: ITGI could have been transformed into ...the southern leg of South Stream, thus transporting *Russian* instead of Caspian gas! **Where is energy security?**

TAP's victory over ITGI (February 2012) was a shock for Greece, which continued to support the latter until the summer of 2012, when it realized that the decision was irrevocable. DEPA again insisted that we would change the verdict, something that never happened... TAP IGA was signed in February 2013. **Missed opportunities** during the

2003-2012 decade resulted in a tough HGA without Greek participation (land lot)

CONCESSION AND PSA REGIMES

- The traditional model of exploration and exploitation in oil and gas is the concession agreement, risky for the investors (IOCs), as they have to finance the project themselves, to pay royalties from day 1 and maybe they don't find anything. Ownership and authority are conceded. The concessionaire has a strong "say" on everything, including exports. In the EU, every single state (except Cyprus) still uses this model. There is rather little room for politics here, as said by Israeli FM Lieberman in Athens (2014): *"The export decisions will be taken by the private sector"*.
- Production-sharing agreements since 1969 are a different story (minimize risk). The investors are entitled to get the entire **"cost oil"** during the first phase, in order to recoup their investment. Still typically it is not theirs, as ownership is *not* conceded. Because sharing takes place afterwards ("profit oil" phase), the state can decide to have a lower profit, in order to advance strategic goals. Therefore, decision-making bodies are always dominated by the NOC's representatives rather than the private investors', no matter who is the majority shareholder!

There seems to be a relationship between UPSTREAM and MIDSTREAM. The nature of the legal agreement with the contractor reflects the power of the state behind export decisions!

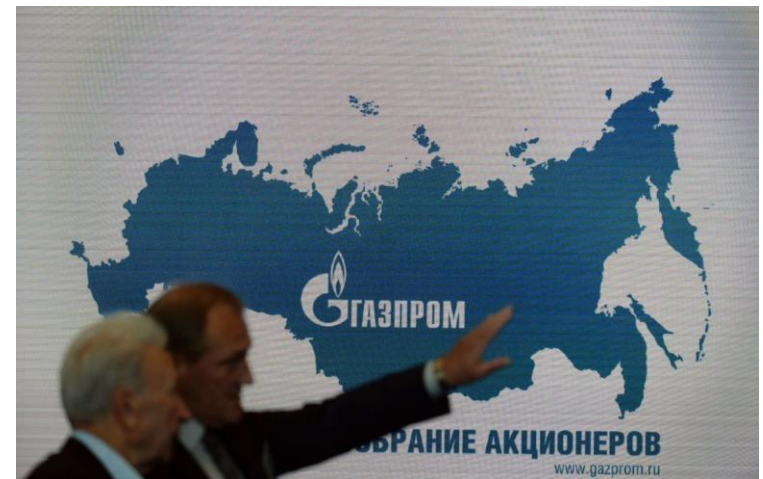
BASIC EXPORT INFRASTRUCTURE ECONOMICS

THE POLICY-MAKERS SHOULD NEVER FORGET

Netback (the final price the importer offers me **minus all costs**, like transportation) is the producer's main criterion. An export project must fulfill certain preconditions to be viable, otherwise it is a non-starter. These include:

- a) Long-term demand: Some markets much more attractive than others, e.g. China better than Europe, with better prospects by 2035 (see *IEA World Energy Outlook*)
- b) Sufficient supply: Empty pipelines and especially those carrying gas with very big diameter are simply non-profitable, e.g. the original (2002-early 2012) “Nabucco Classic” needed much more than SD2 Azeri gas to be viable, which it never found
- c) Financing. Full equity financing is extremely difficult, so bank loans will be needed, sometimes (e.g. NOCs) backed by state guarantees. There is no abundant money around, thus **only the most viable of projects are bankable**. This is of particular importance in “project financing” based on the projected “**cash flows**” of the work itself, rather than the company balance sheets. So the economics matter a lot...

RUSSIA IS THE SOLE MCDONALD'S



Why import gas from the Bear?

- The European view before 2022 spoke about a “win-win” situation increasing the competitiveness of energy-intensive industries and creating a relation of “**symmetric interdependence**” AKA “*rapprochement via interdependence*” (*German political-industrial consensus for 53 years*). While the USSR never cut off the gas supply, the underlying assumptions have proved rather erroneous after the 2022 events
- US view: dangerous for your energy security, especially if Russia is our sole or even dominant provider and, of course, if gas is paramount in the “energy mix”. Even worse for your security overall (\$ trillions since 1992, converted by the R. Federation into weaponry and means of asymmetric warfare)

INTERNATIONAL PRICES MATTER...

“How much the importer offers me minus all costs...”

- ❑ “***First Law of Petro - politics***” means that the international prices of commodities, when high, increase the appetite of producers, especially in paternalistic regimes, to think politically see 2022
- ❑ Putin, a lucky man.... How long?
- ❑ Oil has a universal price (almost...)
- ❑ Gas market still fragmented, but LNG bound to change this sooner or later (erosion of the old “status quo”)

CASE STUDY: GERMANY AND THE SOVIET UNION – RUSSIA since 1/2/1970 (1973)

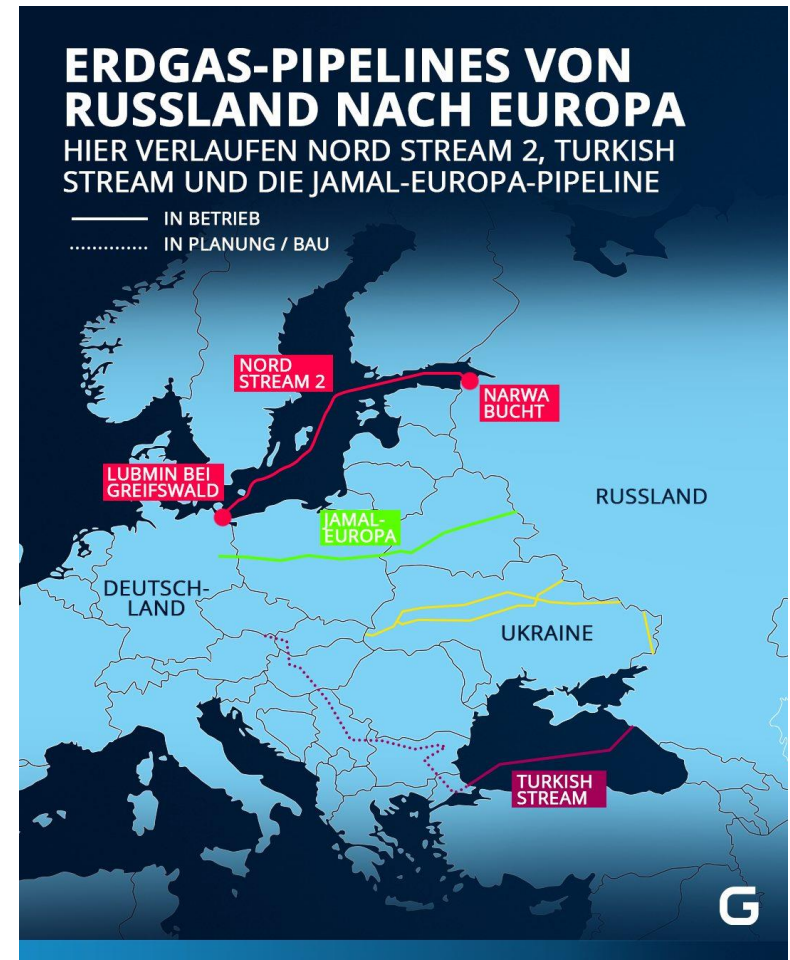


- 1960s: Ruhrgas and Soyuzneftexport negotiated the sale of Soviet gas. The talks coincided with Chancellor Brandt's ***Ostpolitik*** to improve West Germany's relations with the Soviet Union. The pivotal 1970 deal also provided for the export of steel pipes financed by German banks.

The proponents cite the rationale

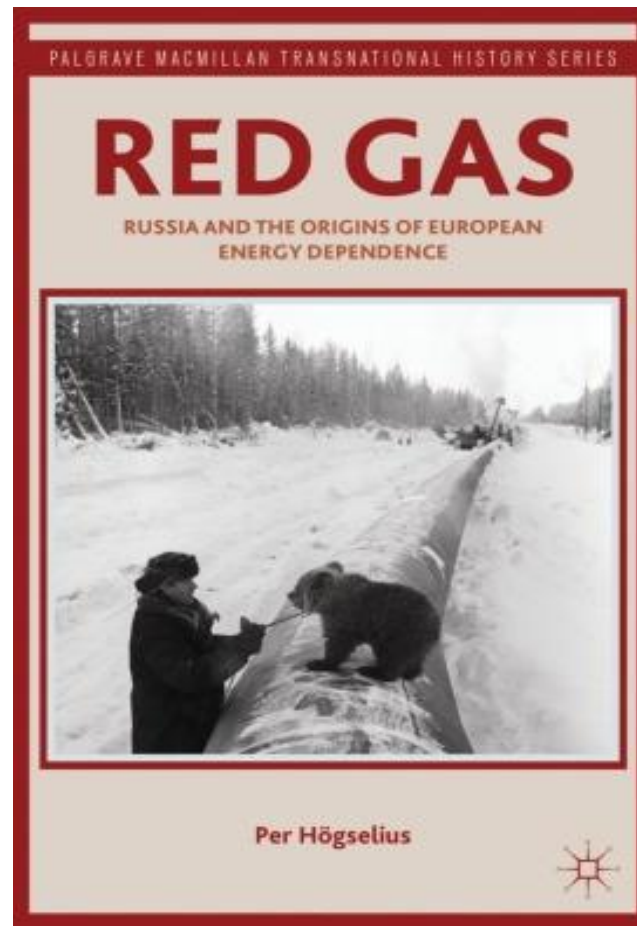


A VERY HAPPY MARRIAGE FOR 52 YEARS TILL 24.2.2022



<https://www.foreignaffairs.gr/articles/basilis-sitaras/o-energeiakos-aksonas-rosias-germanias>

A PIVOTAL
BOOK ON
THE
CREATION OF
THE BILATERAL
RELATIONSHIP
UP TO AND
INCLUDING
NS1 (WHO
WILL WRITE
ABOUT THE
GRADUAL
DECOUPLING
?)



The biggest threat for the “*Bear*”: An (almost) monopsony pipeline relation with China



CONCLUSIONS

- Although export decisions on energy projects *are* indeed affected by political considerations defined by sovereign states, they should not be overestimated. Israel, with a fully diversified economy, no NOCs around and the concession-type licensing agreements, is not the same with land-locked Azerbaijan, possessing a single exportable commodity (hydrocarbons), the national giant SOCAR and a PSA regime. **Caspian-inspired generalizations are dangerous!**
- Sartori, June 2013 “*When it comes to energy, political support and institutional involvement do not always represent the decisive element, and may be counterproductive at times*” (...)
- Most likely, the TANAP-TAP combo, Power of Siberia, Turkish Stream will be the last gas pipelines for many years in Eurasia. The 4-string Nord Stream died, literally, in the fall of 2022. Still pessimistic about East Med...

Bill Clinton, 1992: “It’s the economy, stupid!” This was becoming the case even in international energy cooperation (gas flows), until February 2022...

Russian aggression against Ukraine led to **a come-back of energy geopolitics**. We witnessed sanctions, breach of contractual terms and finally, shut-down of the gas flows. Even the German elites have admitted the failure of symmetric interdependence, dominant in 1970-2022.

Relations built in decades can suddenly collapse for purely political reasons (“*decoupling*”) despite being mutually beneficial economically. Russia’s market share in the EU gas market has been reduced from **45%** in 2021 to **13%** (despite the LNG surge from Yamal). Leaders/states are not always rational actors, as perceived by some IR and decision-making theories...

THE MISLEADING EXAMPLE OF THE FAMOUS BTC



The highly “political” BTC is probably not the best example of an energy infrastructure project on a global scale, because of its paramount importance for Azerbaijani independence, its *relatively* low capital expenditure (less than \$ 4 billion) and the fact that it’s about **oil**, not gas. Economy also played its role: What would have been the fate of BTC without the discovery of the Shah Deniz and Kashagan? Can we imagine it without the leading role of a super-major IOC, such as BP (after the 1998 BP-Amoco deal)? Last but not least, BTC was saved by a sustained period of high prices, otherwise this half-empty pipe would have been problematic.

Some of my older articles (in Greek)

- **-National Oil Companies**, *Foreign Affairs (Hellenic Edition)*, issue n. 22
- **-European Commission versus Gazprom: Legal or Geopolitical Dispute?** *Foreign Affairs (Hellenic Edition)*, issue n. 24
- **-A pragmatic energy diplomacy for Greece**, *Foreign Affairs (Hellenic Edition)*, issue n. 29
- **-Greek energy diplomacy at the crossroads**, *Foreign Affairs (Hellenic Edition)*, issue n. 33
- **-The German-Soviet (Russian) Energy Axis**, *Foreign Affairs (Hellenic Edition)*, issue n. 72

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