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Dedicated to my parents, Lili and Darko.
PART 1: FRAMEWORK

This book centres on studying intricate bargaining relationships between the major actors in the highly politicised oil industry. By covering the period between 1998 and early 2007, this study focuses exclusively on contemporary bargaining in the oil industry, as it is unfeasible to cover a longer time-span. In the current decade, which unlike previous two cooperative decades, can be characterised as conflictual, and thus politicised, the structure of the oil industry can best be understood by studying bargaining between numerous actors, the main of which are the international oil companies (IOCs), oil-exporting states, oil-importing states, and the national oil companies (NOCs).

The central argument is that due to their weak relative bargaining power, the IOCs have been on the losing side in their bargaining with oil exporting countries and/or their NOCs in the current decade when compared to the late 1990s, and thus, we are witnessing the return of the obsolescing bargain. Various factors endow oil exporting countries and their NOCs with high bargaining power vis-à-vis the IOCs. High oil prices, increased industry competition, lack of alternative investment options for IOCs, and an increasingly hostile political climate in many oil-exporting states, together with a number of other factors, translate to weaker bargaining power and unfavourable outcomes for IOCs. The U.S., the world’s largest oil consumer and importer, remains faithful to the markets and this, in turn, is not helping ‘its’ IOCs. Despite the common perception that American IOCs are backed up by the U.S. government, in practice this is rarely the case. Since their interests are not exclusively aligned, American IOCs seldom receive help from the U.S. government in bargaining with other actors, and if they do receive support, then this support does not always result in successful bargaining outcome. Besides oil exporting countries and their NOCs, who are the main beneficiaries of the IOC decline, China’s NOCs are also gaining bargaining power at the expense of the IOCs, and this is not surprising given China’s insatiable thirst for imported oil, and its competitiveness and adoption of non-market measures in obtaining secure access to it. Regardless of their different approach to securing oil supplies, the governments of major oil importing countries, such as the U.S. and China (despite the increase in NOCs’ power), are not guaranteed bargaining success vis-à-vis other actors even if their oil supply security is perceived as threatened. Finally, I found that by using the increased power derived from their oil, oil exporters are also able to gain concessions and achieve their goals in other bargaining arenas. Iran’s continued pursuit of nuclear technology and Venezuela’s spread of Bolivarian Revolution are cases in point.

Given these findings, it is likely that we are going to witness further decline, if not the end, of ‘Big Oil’. Diminishing bargaining power of major IOCs may result in IOCs eventually becoming niche companies, or just shadows of powerful, and both vertically and horizontally integrated companies from the period before oil nationalisations of the 1970s.

Part 1 of this book consists of two chapters. In Chapter 1, I start by briefly outlining the importance of oil for global economy. I proceed by characterising the international oil market as a ‘politcised’ market. Here I also illustrate why studying bargaining relationships among various oil industry actors is the most effective way to study the politics of oil. Following, I introduce the major actors in the oil industry and outline the characteristics of the present conflictual stage in the oil industry. Finally, based on the analysis of these characteristics and issues, I establish various research questions which are the focus of this book. The central question focuses on the IOCs’ future prospects in light of difficult circumstances that they are facing in the contemporary oil industry. In Chapter 2, in light of various research questions outlined in Chapter 1, I analyse various previously established theoretical debates and frameworks in order
to highlight the way in which academia understands these issues and which are helpful in analysing them. This analysis serves as the basis for setting the hypotheses.
EMPIRICAL FRAMEWORK

Introduction

Oil is not ‘just another commodity’. It is “the world’s most important traded commodity”, and “by far the most important energy source in the world economy.” Whatever the evolution of new international order, oil will remain the strategic commodity, critical to national strategies and international politics. Today, we are so dependent on oil, and oil is so embedded in our daily doings, that we hardly stop to comprehend its pervasive significance. No other form of energy is used as widely or as intensively in the global economy today as oil, which has maintained its prominence largely because it is the only energy source that has such a multiplicity of uses – for heating, as an industrial fuel supply, and to generate power – and most importantly because it continues to be unrivalled in the transportation sector. Besides being a primary source of fuel, its derivatives are equally important because they appear in almost everything we use in our daily activities, such as products made of plastic or rubber, ranging from household utensils to clothing items. Further, it remains abundant, relatively inexpensive and more readily and cheaply transported across long distances than any of its competitors. The availability of vast quantities of relatively inexpensive oil is indispensable to a whole host of industries, which besides transportation sector include automobile manufacture, road and highway construction, airlines, petrochemical, agriculture, tourism, and suburban commerce. Taken together, these sectors make up the heart of the economy, and without cheap oil, they – and the way of life they make possible – could hardly survive.

The prices of oil and its refined products affect the cost of almost everything. They help determine not just the cost of driving to work or flying off on holiday, but also the cost of

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furniture, food and anything else, which has to be transported from factory to shop floor. Oil and product prices affect inflation rates, trade balances, and even macro-economic policies of all countries, as well as governments’ re-election chances, and thus remain a key determinant of global economic performance. A painful reminder of the critical role of this dependence for the economy is the fact that nearly every economic recession in the West since World War II has come on the heels of an oil crisis. The crucial importance of oil for global economy warrants that it should be at the centre of our academic inquiry.

In this chapter, I characterise the international oil market as a ‘politicised’ market, which allows for integration of political and economic aspects in influencing market and bargaining outcomes. Since the international oil industry is politicised, bargaining, a process at the heart of all political and economic exchanges in contemporary society, plays the central role between various actors in such an environment. Thus, studying bargaining relationships among various oil industry actors is the most effective way to study the politics of oil. After introducing the major actors in the oil industry and outlining their characteristics and interests, it becomes obvious that the international oil industry can be characterised as a mixed actor model, as there are a number of key actors but none evidently predominant. Moreover, while surveying the contemporary oil industry, I argue that the oil industry is an industry in which large economic rents can be earned and bargaining determines the division of these rents. While the 1970s and early 1980s were the years in which oil produced for the international oil market was progressively brought under state control, and the 1980s and the 1990s can be characterised as a cooperative stage in which the IOCs managed numerous ‘sweetheart’ deals, the oil industry has in recent years shifted to a conflictual phase characterised by resource nationalism and the revival of energy security concerns among major oil importers. In the current decade, the IOCs find themselves in a particularly challenging situation, as they are struggling to replace their reserves, and as oil exporting governments and their NOCs reassert dominance over the industry. Oil exporters are helped by increased competition that the IOCs face from oil importing, and particularly China’s NOCs, which are backed by unconditional financial and political support by their home governments. Finally, based on this analysis, I establish various research questions which are the focus of this book. The central question is concerned with the IOCs’ future prospects in light of possibly insurmountable hurdles that they are currently facing.

10 Oil market turbulence, according to Øystein Noreng, has contributed to Western presidents not being re-elected, as happened in the United States to Gerald Ford in 1976, to Jimmy Carter in 1980 and to George Bush Sr. in 1992, as well as in France to Valéry Giscard d’Estaing in 1981 and in Germany to Helmut Schmidt in 1982. Noreng, Crude Power, p. 5.
1.1 Oil: Politicisation and Bargaining

Politicisation

The ‘politicised’ model is useful in understanding the functioning of the oil industry. According to Helge Ole Bergesen and Edward Wilson, politicisation is referred to as the interference of a government in the international oil market. Oil market politicisation entails that the price of oil is much more than merely the amount of money at which supply and demand meet. When looking at determinants of the price of crude oil, despite the importance of economics, “oil remains a political commodity.” According to Youssef Ibrahim, “[oil] is the one strategic commodity of the world that governments, from superpowers to minor states, will never allow to be free of political control.” According to Edward Morse, “If the history of the political economy of oil provides any lesson, it is that market factors have never been allowed to operate on their own,” and thus, “there is no reason to expect that the future will change this situation.” In recent years the international oil industry has been as politicised as it was in the heyday of resource nationalism in the 1970s.

Governments intervene in oil markets to serve their national interests regardless of ideology and pronounced economic preferences. Governmental impact is inevitable in the realm of the oil industry and by which the working of the straight market economy is affected, and there is no country or region in which there is no trace of one or more forms of governmental impact. Governments are involved in the following ways:

- by safeguarding against ‘abuses of power’ by the biggest commercial units, hence making it more difficult for the most powerful operators in the industry to fundamentally affect the working of the market;
- by imposing measures designed to further national security, which can safeguard and support some operations and/or operators, at home and/or overseas (buying equity oil), whose activities are deemed to be in the national interest, hence possibly constraining other operators;
- by imposing taxes, which affect the price to the consumer and to the regime covering the production phase of the industry; in most OECD countries, high taxation of oil products puts upward pressure on prices of those products, even when market conditions try to drive them down.

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13 Vaitheeswaran, *Power to the People*, p. 100.


19 Today, most countries tax oil products, usually through a general sales tax, or value-added tax, and a special excise tax or duty. On average, in 2001, about two-thirds of the end-user price of oil products in the E.U was tax, with oil exporters and refiners and distributors sharing the rest fairly equally. The major cost factor to European and Japanese motorists is their own government, not the oil producers or the oil industry. See Noreng, *Crude Power*, p. 182.
by setting up state-owned or -backed enterprises, which, though designed to follow industrial guidelines, often follow governmental policies, which might be in contradiction with free market principles;  

by implementing increasingly stringent environmental standards, they complicate investment in oil industry in general and refining capacity in particular;  

by build-up of government-held or controlled oil inventories which are meant to serve as shock absorbers that significantly alleviate the need to adjust rapidly to supply shortfalls, and to keep a ceiling, or at least a downward pressure, on prices;  

by imposing economic sanctions (particularly by the U.S.) or waging war against rogue oil producing states in order to use the oil weapon as a foreign policy tool; alternatively, oil-exporting states can embargo their oil exports in order to achieve their foreign policy goals; and  

by signing strategic and often less profitable government-to-government, long-term supply contracts, often accompanied by destination clauses, which guarantee stability for both sellers and buyers, hence bypassing the most lucrative markets.

It is imperative to note that although oil markets are politicised, they are also markets and it would thus be unwise to ignore the role of the economics. Since it is impossible to separate politics and economics in practice, neither governments nor markets alone can determine outcomes. While government actions clearly affect market outcomes, changing market outcomes also condition state behaviour. For example, the price of oil dictates the amount of investment in the oil industry, in what is commonly referred to as the ‘long run investment cycle’, or the ‘petro-political cycle’. The price spikes are usually followed by substantial overinvestment across the

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20 The first four ways governments intervene in the oil markets have been proposed by Frankel, “Oil: ‘Market Forces’,” p. 7.  
22 These “buffer stocks” come in two forms. Some of them are government-owned and held, as in the case of the United States’ very large Strategic Petroleum Reserve (SPR), while others are mandated by governments but held by refiners. Morse, “A New Political Economy of Oil?” p. 20.  
24 Many oil-exporting governments sacrifice higher profits in order to maintain political relationships and to diversify their demand base. Valérie Marcel, Oil Titans: National Oil Companies in the Middle East (London: Chatham House, 2006), p. 203.  
25 Ernest Wilson’s petro-political cycle (PPC) model posits that the likelihood and the direction of market politicisation are a direct function of the boom-and-bust phase of that market; thus, petro-politicians at the peak of the market will differ substantially from politics at the trough. In rising markets, sellers, such as oil exporting governments, gain leverage; in falling markets, buyers, such as the IOCs or oil importing governments, gain leverage. In addition, in times of rising prices, developing governments, which occupy a subordinate position in the international system, have real incentive to alter the basic rules of the game and reverse this status quo. While their chances of doing so improve greatly in rising markets, they decline in falling ones. See Ernest J. Wilson III, “The Petro-Political Cycle in World Oil Markets,” in Richard L. Enders and John Kim (Eds.), Energy Resource Development: Politics and Policies (Westport, CT: Greenwood Press, 1986); and Wilson, “World Politics and International Energy Markets,” pp. 144-7.
whole industry, which eventually leads to the fall in oil prices as a consequence of the excess capacity stimulated by the earlier investment boom. In turn, low prices result in the period of underinvestment, which in the long run contributes substantially to sharp price increases, thus closing the cycle. Currently, however, despite the almost record high oil prices, the investment boom is not as evident as it was previously under similar market conditions. This is particularly so since most of the areas with the cheapest to produce oil reserves and largest assets, located in Russia and OPEC countries, are not in the hands of the most efficient and best-capitalised firms, Western IOCs, but non-Western governments and their NOCs, thus highlighting the importance of politics.

The famous British economist Alfred Marshall was once asked which side of the market determines price – supply or demand? He replied by asking which blade of scissors cuts a ribbon? The correct answer, of course, is both. If Marshall were alive today, we might ask him which force determines the price of oil – states or markets? Similarly, his answer would most certainly be ‘both’. In reality, oil can be understood most effectively through integrating insights from both economics and politics. Without this synthesis there exists the kind of problem identified by Robert Gilpin, in which political scientists tend to overlook the role of markets, while economists often neglect the importance of power and the political context of events. Conceptualising the oil market as ‘politicised’ avoids falling into the trap identified by Gilpin, as it allows for integration of political and economic aspects. Although political events are very important, the price of oil is also a very important factor in influencing bargaining outcomes in the oil industry.

**Bargaining**

Above, I established that oil is a politicised commodity since the oil markets are highly susceptible to strong political forces. Thus, studying the contemporary oil industry by examining bargaining relationships among the major actors is the most effective way to approach it. Bargaining is a process at the heart of all political and economic exchanges in contemporary society and the very essence of politics itself. It encompasses many activities in addition to formal negotiations. For example, when the United States and the USSR threatened new deployments of nuclear weapons, announced peace initiatives, or broke off negotiations, they were bargaining. When a small, developing state sets terms for a multinational corporation to do business within its borders, the two are bargaining. When U.S. and North Korean troops fought battles over the line of demarcation, they were doing so as part of their governments’ bargaining. Since bargaining between various actors is what shapes the political and economic exchanges, bargaining between various actors in the oil industry shapes the political economy of oil. Thus, studying bargaining is crucial for understanding the balance of power between major actors in the industry. Conflicting preferences of various actors (examined in more detail in the following section), as well as their power, make the oil industry a significant bargaining arena. Since oil is a commodity of utmost importance for most, if not all states and other actors in the global political and economic arena, it is also the political bargaining chip of last resort, which is

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26 Gilpin, U.S. Power and the Multinational Corporation, pp. 4-5.
27 Strange, States and Markets, p. 190.
28 I characterise a bargaining situation by the coincidence of cooperative and conflictual elements in addition to a limited degree of interdependence. Since the words bargaining and negotiation are frequently used interchangeably in the literature, I subscribe to the view of bargaining which includes the exchange of verbal as well as non-verbal communication, formal as well as informal exchanges. Negotiation thus refers to a formalised process relying on verbal communication, and as such, it is a sub-class of bargaining. For more on bargaining and negotiation, see Christer Jönsson, “Diplomacy, Bargaining and Negotiation,” in Walter Carlsnæs, Thomas Risse and Beth A. Simmons (eds.), Handbook of International Relations (London: SAGE Publications, 2002).
commonly used by states and other actors in international relations and the international political economy.

It is important to note that both those who approach international relations from the realist tradition and those who use other approaches conceive of bargaining as a central process. Bargaining behaviour is an important component of realism.\textsuperscript{29} It is also a key feature of the main rival to realism, liberalism. Keohane and Nye have noted that “Realism and liberalism both have their roots in a utilitarian view of the world, in which individual actors pursue their own interests by responding to incentives. Both doctrines view politics as a process of political and economic exchange, characterised by bargaining.”\textsuperscript{30} However, a bargaining perspective offers valuable correctives to both neorealism and neoliberalism. Whereas realism focuses on explaining conflict and struggles to explain cooperation, and liberalism focuses on explaining cooperation and struggles to explain conflict, bargaining theory highlights the conjunction of cooperation and conflict in most international relations.

1.2 The Characteristics of the Contemporary Oil Industry

1.2.1 Major Actors: Characteristics and Interests

This section answers the following questions: Who are the major actors in the contemporary oil industry, what are their major features, and what are their interests? Major actors in the oil industry are the oil importing and exporting states, both of which are sometimes organised into cartels or intergovernmental organisations (such as the Organization of Petroleum Exporting Countries or OPEC, and the International Energy Agency or IEA), and the oil companies, including international and state-run or national companies. Oil exporting states are usually in control of their own national oil companies (NOCs), and the interests of the two are identical most of the time. Some oil importing states have their own NOCs (for example China), with interests closely aligned to that of their state. Others use private international oil companies (IOCs), which sometimes have converging and, at other times, conflicting interests to those of oil importing states. Historically, these actors have had different levels of influence on the oil markets at different times. In separate accounts, Alessandro Roncaglia, Paul Stevens and Maurice Adelman describe the international oil market as a trilateral oligopoly made up of three groups of actors – exporting states and their NOCs; importing states; and the IOCs.\textsuperscript{31} However, their conceptualisation outlived its usefulness, as some oil importing states have their own NOCs and should not be grouped with importing states that rely on the IOCs for their oil supplies.

One should guard against the assumption that members of each group are homogeneous, have identical interests, or concur in their optimal strategies. Explicit or tacit coalitions, which can lead to a certain degree of cooperation across these groups, are commonplace. Their interests, and particularly those of states, are often quite complex, clearly not as simple as interests of private oil companies, which are primarily concerned with profit maximisation. Below, I briefly survey the major actors.

**Governments**


Rather than distinguishing between producers and consumers, I divide countries into net exporters and net importers, because some countries, such as the U.S., China, Russia, Canada, and Mexico, are in top ten of both consumer and producer categories. Thus, classifying them as net exporters (Russia, Mexico, and Canada) and net importers (the U.S., and China) adds clarity and removes ambiguity about their categorisation.

**Exporters**

Of ten largest crude oil exporters in the world, all but three (Russia, Norway and Mexico) are members of the Organization of Petroleum Exporting Countries, or OPEC (see Table 1.1). Additionally, six countries with the largest crude oil reserves in the world are also all OPEC states, and all, but Venezuela, are located in the Middle East. These five countries control 59.6 percent of total world proven reserves. Although they produce 41.7 percent of world’s crude oil, OPEC states possess 75.2 percent of total proven world oil reserves, which are adequate for about 73 years of production at current rates (see Table 1.2). This suggests that OPEC’s already considerable market power will only grow in the future.

### Table 1.1: Net Oil Exporters and Importers (2005)

<table>
<thead>
<tr>
<th>Country</th>
<th>Net Exports Million BPD</th>
<th>Net Imports Million BPD</th>
</tr>
</thead>
<tbody>
<tr>
<td>Saudi Arabia</td>
<td>9.144</td>
<td>USA</td>
</tr>
<tr>
<td>Russia</td>
<td>6.798</td>
<td>Japan</td>
</tr>
<tr>
<td>Norway</td>
<td>2.756</td>
<td>China</td>
</tr>
<tr>
<td>Venezuela</td>
<td>2.454</td>
<td>Germany</td>
</tr>
<tr>
<td>Iran</td>
<td>2.390</td>
<td>S. Korea</td>
</tr>
<tr>
<td>UAE</td>
<td>2.375</td>
<td>France</td>
</tr>
<tr>
<td>Kuwait</td>
<td>2.363</td>
<td>India</td>
</tr>
<tr>
<td>Nigeria</td>
<td>2.305</td>
<td>Italy</td>
</tr>
<tr>
<td>Mexico</td>
<td>1.781</td>
<td>Spain</td>
</tr>
<tr>
<td>Algeria</td>
<td>1.761</td>
<td>Netherlands</td>
</tr>
</tbody>
</table>

Source: BP Statistical Review of World Energy 2006 (OPEC in red, OECD in blue)

### Table 1.2: OPEC, OECD, and non-OPEC Oil Reserves, R/P Ratio and Production (2005)

<table>
<thead>
<tr>
<th></th>
<th>OPEC</th>
<th>OECD</th>
<th>Non-OPEC</th>
<th>World</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reserves (billion barrels)</td>
<td>902.4</td>
<td>80.6</td>
<td>298.3</td>
<td>1200.7</td>
</tr>
<tr>
<td>% of World Total</td>
<td>75.2%</td>
<td>6.7%</td>
<td>24.8%</td>
<td></td>
</tr>
<tr>
<td>Production (million bpd)</td>
<td>33.836</td>
<td>19.763</td>
<td>47.252</td>
<td>81.088</td>
</tr>
<tr>
<td>% of World Total</td>
<td>41.7%</td>
<td>24.4%</td>
<td>58.3%</td>
<td></td>
</tr>
<tr>
<td>R/P Ratio (years)</td>
<td>73.1</td>
<td>11.2</td>
<td>17.3</td>
<td>40.6</td>
</tr>
</tbody>
</table>

Source: BP Statistical Review of World Energy 2006

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32 Currently, there are eleven members of OPEC: Saudi Arabia, Iran, Iraq, Kuwait, UAE, Qatar, Venezuela, Libya, Algeria, Nigeria and Indonesia.

In a country with substantial oil resources, which at the same time, is a net oil exporter, the state has several interests to consider and protect. These interests range from security of supply on the domestic market; health; safety; welfare and environmental interests; the conservation of oil resources for future needs; the training and employment of local labour in the oil industry; and finally, the generation of proper returns on the exploitation of oil resources for the state by the means of maximisation of gains from exports of crude oil or refined products. In order to fulfil these goals states need sovereignty over their oil industries, a power that most oil exporting states legally achieved after the World War II. Pre-nationalisation foreign dominance of oil exporting countries’ oil industries implied a technological and commercial dependence, so that foreign actors took decisions of crucial economic and industrial importance for host countries. Additionally, foreigners were more responsive to consumer interests than to those of the producers, compromising national sovereignty in economic matters. As illustrated by the period following nationalisation of the oil industry in many exporting countries, domestic ownership and control of oil was essential in order to be use for host state’s national interest, rather than the interest of IOCs and/or foreign governments.

Following nationalisations in oil exporting states, states became the primary agents of the economy and the generators and distributors of the oil rent. As ‘rentier states,’ many oil exporters are characterised by the capacity of the state to distribute large amounts of financial resources to society. A common characteristic of all ‘rentier states’ is that the regime’s legitimacy “has been built around its capacity to distribute rent to different segments of society,” both to a regime’s allies but also to its potential challengers and the poorer segments of society. In other words, many oil-exporting countries “buy” regime stability, and therefore maintain the status quo by redistributing oil income to society. Where a leader without revenue rents has to bargain with individuals and organisations that support him/her in order to stay in power; the electorate in countries with large oil revenues heavily depend on the leader’s distribution strategies, and thus, have significantly less bargaining power against the leader. While the political pact of the ‘rentier state’ eroded in many oil-exporting countries when oil prices fell in 1986, it is back on the agenda in the current decade, as oil prices have reached almost record levels.

Many have considered all Organisation of Petroleum Exporting Countries (OPEC) and many non-OPEC oil exporters (excluding OECD exporters) as ‘rentier states’ and ‘petro-states’, as oil abundance has been considered a curse for developing countries. In other words, oil riches are

35 These resources did not come from taxes, and therefore give the state a degree of autonomy from society.
36 Marcel, Oil Titans, p. 107. Also, see Noreng, Crude Power, pp. 117-33.

far from the blessing they are often assumed to be. In fact, countries with bad institutions often end up poor and suffer what is known as ‘resource curse’, ‘the Dutch disease’, or the ‘paradox of plenty’ precisely because they are oil rich. Oil is considered as a ‘fool’s gold’ – bad for growth and bad for democracy, since it tends to impede the development of institutions and values critical to open, market-based economies and political freedom: civil liberties, the rule of law, protection of property rights, and political participation. Moreover, structural consequences caused by the heavy reliance on a single mineral commodity (or a few commodities) for much of budget revenues carry a consequential impact of a strong exchange rate. This, in turn, makes it difficult for the rest of the trading sector to compete, and thus broader based economic development is impeded. Historically, states suffering from the Dutch disease have been prone to outside interference by larger states wanting some control over either the price or supply of oil. However, following the recent oil price surge, indications are that Middle Eastern OPEC and other oil exporters have learnt their lessons from 1974 and 1980 and are saving and investing their oil revenues wisely. While past windfalls have been celebrated with budgetary blowouts and the abundance of money has encouraged the postponement of economic reforms, this time around, most Middle Eastern OPEC oil exporters, with the possible exception of Iran, seem to be spending less, repaying debts, building up assets due to an impressive transformation of the region’s financial and economic base, and spending more on health, education and infrastructure.

“Saving Iraq From Its Oil,” Foreign Affairs, vol. 83, no. 4, July-August 2004, p. 77. The only oil exporters not included are all Western OECD countries: Norway, Canada, the UK, and Denmark. Arguably, the chances of overcoming the curse are greatest in countries with well-developed political and civic institutions, such as Norway or Canada. Jason Bush, “The Curse of $50 a Barrel,” Business Week, May 16, 2005, p. 33.

Philipp, The Political Economy of International Oil is an excellent source for those wishing to understand why the vast oil revenue has not brought about substantial economic and social development in the member states of OPEC. This subject is also covered in Paul Hallwood and Stuart Sinclair, Oil, Debt and Development: OPEC in the Third World (London: Allen & Unwin, 1981). Amuzegar, Managing the Oil Wealth: OPEC’s Windfalls and Pitfalls, looks at the oil producers on a country-by-country basis and argues that mismanagement played a significant part.


Terry Lynn Karl defines petro-states as the countries where the petroleum sector is at the centre of economic accumulation, and where the central institutional feature is fiscal dependence on petro-dollars. The petro-states are economically dependent on a single resource (oil) that is a finite commodity “capable of generating extraordinary rents”; they depend on a capital-intensive industrial sector and they have oil rents accruing directly to the state. Oil exports create powerful organised groups in both government and the business community with strong interests to maintain the status quo by moulding institutions to serve this purpose. The government’s reliance on oil revenues and taxes from the oil industry for its revenue base has two effects: firstly, the state fails to develop a culture of taxation similar to other countries. Secondly, a rentier mentality develops along with an institutional base that serves to perpetuate the state’s reliance on oil. This creates high barriers to change, which later impede the structural readjustment needed as a response to declining revenues from oil exports. Karl, The Paradox of Plenty.


For example, it has been suggested that Saudi Arabian economy is moving beyond oil. See Stephen Glain, “Moving Beyond Oil,” Newsweek, June 27, 2005, pp. 36-8; and M.A. Choudhury and M.A. Al-Sahliwi, “Oil and Non-oil Sectors in the Saudi Arabian Economy,” OPEC Review, vol. 24, no. 3, September 2000. Michael Alexeev and Robert Conrad (“The Elusive Curse of Oil,” Working Paper Series, Terry Sanford Institute of Public Policy, Duke University, August 2005) have shown that the effect of a large endowment of oil on long-term economic growth of countries has been positive. T. Ashby McCown, L. Christopher Plantier and John Weeks (“Petrodollars and Global Imbalances,” Department of Treasury, Office of International Affairs, Occasional Paper, no. 1, February 2006, p. 2) have argued that in contrast to the last oil boom, some oil exporters have responded to the windfall by increasing reserves, retiring debt, financing productive investments intended to support growth, and setting aside money for future generations, measures which should help insulate them from oil price volatility. Also see “Mid-East ‘ Learns Oil-boom Lesson’”, BBC News, June 29, 2006, http://news.bbc.co.uk/go/pr/fr/-/hi/business/5129512.stm; [June 30, 2006]; “Recycling the Petrodollars,” The Economist, November 12, 2005, pp. 77-9; and Stephen Roach, “The
Oil-exporting countries may use a strategy of collective action, a perfect example of which is OPEC, which was established in 1960 by Iran, Iraq, Kuwait, Saudi Arabia and Venezuela, at a time when the balance of power within the oil industry preponderantly favoured the consumer.\(^45\)

In economic terms, its intention was to establish a cartel arrangement between developing states in the oil industry to maintain a price structure that would reflect the perceived interests of its member states, rather than that of the United States with its import restrictions,\(^46\) and oil companies, which had set prices and production levels hitherto. As a result, the main objectives of OPEC stress the importance of stable oil prices and income from oil export for the member states.\(^47\) OPEC’s move into the centre ground as the price-maker for crude oil came in the early 1970s. However, disarray within OPEC has been more or less a constant, and it could not and cannot act as a cartel to rig the oil market.\(^48\) Arguably, OPEC is “first and foremost a political organisation of economically heterogeneous countries with clashing national and even economic interests.”\(^49\)

Internal division is usually evident between the price hawks (Libya, Venezuela, Iran, Nigeria and Indonesia), and countries close to the West with a moderate line on prices (Saudi Arabia, Kuwait, and the UAE), and the conflict often centres on hawks’ ‘free riding’. In other

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\(^46\) The U.S. implemented the Mandatory Oil Import Program (MOIP) in March 1959 in order to shift the burden of adjustment from the U.S. oil industry to the rest of the world. Morse, “A New Political Economy of Oil?” p. 9.

\(^47\) In Article 2 sub A, B, and C, Chapter 1 of the Statute of the Organization of the Petroleum Exporting Countries (OPEC), the main aims are set forth: the coordination and unification of the petroleum policies of member states; the determination of the best means for safeguarding the individual and collective interests of the member states; stability of prices in international crude oil markets in order to eliminate harmful and unnecessary fluctuations; due regard to the interests of the producing nations and to the necessity to secure a steady income; an efficient, economic and regular supply of petroleum to consumer countries; and a fair return on capital to those investing in the oil industry. OPEC, *Official Resolutions and Press Releases*, (Vienna: The Secretariat OPEC, 1960-1990), p. 32.

\(^48\) See in particular, Skeet, *OPEC: Twenty-five Years of Prices and Politics*; Terzian, *OPEC: The Inside Story*; and Noreng, *Crude Power*, chapter 3. On the contrary, Raymond J. Leary, who surveyed OPEC’s methods of economic dominance and suggests how to bust it, suggested that OPEC acts as a cartel, and manipulates the oil markets and destabilises the world economy. See *Over a Barrel: Breaking the Middle Eastern Oil Cartel* (Nashville: Nelson Current, 2005).

words, there is often a strong incentive to cheat, and produce more, or less, oil than prescribed by the quota system. Although the pursuit of a coordinated or even uniform oil policy by the member states was considered highly important for the realisation of OPEC’s objectives, this cannot be achieved until there are converging developments in the oil industries and economies of member states. Besides the fact that there are no legal repercussions if a member violates an agreement, since no legally binding agreements are made, OPEC countries do not have enough common interests to maintain price solidarity for long. Moreover, the group is too heterogeneous to agree as national interests clearly prevail, and the relationship between the members of OPEC is not like that of a community of states. In addition, several of the OPEC members (Iran, Iraq, and Kuwait) have been involved in military conflicts with one another, what further contributes to cartel’s lack of cooperative success. In recent years, OPEC’s market power has diminished as, except for that of Saudi Arabia, which has historically been known as the swing producer, the cartel nowadays lacks high spare production (or excess) capacity of past decades.

Importers

In 2005, eight out of ten largest importers of crude oil were OECD countries (see Table 1.1), with the United States far ahead of any other country. Besides the OECD countries, which in 2005 imported 29.5 million bpd, 12 million bpd more than they did two decades ago, emerging market economies, such as China, which became a net oil importer in 1993, are in desperate need for additional oil (see Table 1.3). China’s emergence as a major oil importer has occurred both relatively recently and quite rapidly. Between 2001 and 2005, China accounted for 35 percent and the United States for 17 percent of the total increase in global crude oil demand. Put together, in 2005, OECD countries and emerging market economies of South, East and Southeast Asia consumed 77.7 percent of the world’s oil, and they absorbed much of world’s traded oil.

Table 1.3: Increasing Net Oil Imports in the OECD, US and China

<table>
<thead>
<tr>
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</thead>
<tbody>
<tr>
<td>Production</td>
<td>20,060</td>
<td>19,763</td>
<td>11,297</td>
<td>6,830</td>
<td>2,841</td>
<td>3,627</td>
</tr>
<tr>
<td>Consumption</td>
<td>37,217</td>
<td>49,254</td>
<td>14,710</td>
<td>20,655</td>
<td>2,662</td>
<td>6,988</td>
</tr>
<tr>
<td>Net Imports</td>
<td>17,157</td>
<td>29,491</td>
<td>3,413</td>
<td>13,825</td>
<td>-0.179</td>
<td>3,361</td>
</tr>
</tbody>
</table>

Source: BP Statistical Review of World Energy 2006

50 Falola and Genova, The Politics of the Global Oil Industry, p. 67. Given the pressure of socioeconomic demands and the need for quick, easily fungible revenues, ‘needy’ and hawkish oil-exporting governments (Iran for example) are more inclined to exploit the short-run inelasticity of demand for oil. By pushing for higher oil prices, however, these governments may accelerate the oil substitution or conservation process, hence pushing the prices down in the longer period. If, however, oil-exporting governments feel that future prices (in real terms) are likely to be higher, and assuming that they have no immediate profitable use for funds, they may prefer to defer production and keep the major national asset in the ground (Saudi Arabia for example).


52 Claes, The Politics of Oil-Producer Cooperation, p. 163.


55 China, Hong Kong, Taiwan, Vietnam, Thailand, the Philippines, Singapore, Malaysia, Indonesia, Bangladesh, India and Pakistan. Ibid.
At first glance, the problems that industrial nations face today in acquiring secure sources of oil may seem more acute than ever before. The United States, Japan, China, and the European Union are heavily dependent on oil imports - they consume 57.8 percent of world’s oil, and import 70.1 percent of all traded oil. Current production figures significantly underestimate the longer-term dominance of the Middle East, as oil production in most OECD countries has already peaked. The future importance of Middle East and its oil is further exacerbated by the projection of import fractions in the United States – rise from 33 percent in 1985, to 67 percent in 2005 and to around 80 percent in 2025. The import fraction in the European Union is expected to rise from 84 percent in 2005 to around 90 percent in 2025. In Japan, it is already at 98 percent and is expected to be 100 percent in 2025. Finally, in China, it grew rapidly from zero in 1992, to 27 percent in 2000, 48 percent in 2005, and it is expected to reach 73 percent by 2025. It is obvious that major world powers are all increasingly dependent on imported, and particularly OPEC oil, and the uneven endowment of oil can easily be translated into political and diplomatic problems for those who lack abundance in oil reserves.

Preoccupied with balance of payments problems, inflationary pressures, and concern over availability of supplies, oil-importing governments generally aim at lower disbursements for oil imports, consistent with their perceived objective of security of supplies (or energy security), which usually refers to uninterrupted availability of oil at stable and reasonable prices. Some have even suggested that Western governments, and in particular those endowed with oil, such as the U.S., U.K., Norway and Canada, need relatively high prices to provide an umbrella under which their higher-cost supplies of oil can be developed. For oil importing nations, security of supplies can be satisfied through diversifying sources of imports; developing competitive domestic production of oil or of any substitute products; assisting state-owned or private oil companies with headquarters in that particular country in their overseas ventures; and by engaging in demand-management by reducing domestic oil consumption. Oil importers are rivals for market shares as they find themselves in competition or even conflict with each other in order to secure sufficient oil needed to run their economies.

It is thus unsurprising that in every oil-importing nation, energy security is high on both domestic and foreign policy agendas, and securing an adequate supply of oil is a paramount concern. Two oil crises that erupted in the 1970s brought energy security to the forefront of many governments’ objectives, and also resulted in increased academic interest. The importance that various oil-importing governments ascribed to energy security diminished by the mid-1980s, when oil prices were low and supplies were abundant, but has been revived in recent years. This revival and the new age of energy security are driven in part by an exceedingly tight oil market and by high oil prices. According to Yergin, other factors include the threat of terrorism, inclement

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58 Oil-importing countries could support or tolerate efforts of oil-exporting countries and/or oil companies to raise prices within acceptable limits if there are trade-offs involved. For more detail, see Zuhayr Mikdashi, The International Politics of Natural Resources (Ithaca, N.Y.: Cornell University Press, 1976), p. 32.
weather, instability in exporting nations, resource nationalism, fears of a scramble for supplies, geopolitical rivalries, countries’ fundamental need for energy to power their economic growth, and anxiety over whether there will be sufficient resources to meet the world’s energy requirements in the decades ahead.\(^6^1\) One driver of the renewed focus on energy security, which is not mentioned by Yergin, is that some states consider the economic and environmental impact of demand, rather than security of supply, as one of the key issues in their energy security.\(^6^2\) However, the key energy security policy driver for most, if not all states, is that security of oil supplies is taken as a necessary precondition in ensuring progress and economic growth. While this clearly is the case in the UK,\(^6^3\) in formal political discourse in the U.S., petroleum is considered a national security matter.\(^6^4\) In his speech at the Brookings Institution in 2006, Senator Richard Lugar, chairman of the Senate Foreign Relations Committee, warned, “Energy is the albatross of US national security.”\(^6^5\) According to American neo-conservatives, such as Richard D’Amato, Chinese ownership of an American oil company (UNOCAL) would not only be a threat to economy, but also to the national security.\(^6^6\)

Similarly, emerging economies of Asia, such as China and India, according to Michael May, depend for “probably most of their continued economic growth on the continued normal functioning of world [petroleum] markets … for the exports needed to pay for these products.”\(^6^7\) In other words, economies in Asia require energy to fuel their export-led development and growth. Hence, in China for example, according to Bo Kong, “energy security is now firmly at the top of the leadership’s domestic and foreign policy agenda.”\(^6^8\) and according to Mao Yushi, “oil supply security has become the contemporary imperative.”\(^6^9\) Whereas most oil importers rely on the IOCs to supply their crude oil and products, China and India have their own NOCs, which perform this function. While IOCs are often independent of any home government interference, Chinese and Indian NOCs are government-controlled and most often follow directions prescribed by their governments. Thus, in ensuring their energy security Chinese and Indian NOCs receive state support, since their governments consider oil a strategic asset.\(^6^0\) In this way, China and India can directly serve their interests in the oil markets by relying on their NOCs rather than on the IOCs. The NOCs, and the role they play in serving governments’ interests, will be examined in more detail below.

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\(^n\) Klare, Blood and Oil, p. xiv.
Not unlike the oil-exporting countries, oil importers may also use a strategy of collective action. In 1973/74 the United States took the initiative in re-tabling a proposal that states in the OECD should act in concert to confront the producers’ cartel (OPEC) with a countervailing consumers group, in order to push the prices down, and reduce the impact of unleashing the ‘oil weapon’ in future.\(^71\) Thus, they formed the IEA, the origins of which can be found in the 1973 oil embargo.\(^72\) As a response to this embargo, the U.S. government, under the direction of then Secretary of State Henry Kissinger, called for the establishment of the IEA, which eventually took place in 1974. The U.S. objectives were both economic and political, aiming at lower oil prices, development of new energy sources, confronting OPEC’s emerging power, which was seen as a challenge to U.S. hegemony, and preserving the position of U.S.-based IOCs in supplying OECD countries with oil.\(^73\) The United States was not successful in making the IEA a counter-cartel to OPEC under its own control, as the economic objectives were contradictory and the political objectives met with resistance from Western Europe and Japan, which did not want to compromise their relations with the OPEC countries. In hindsight, the IEA has failed in its original objectives,\(^74\) as until this day, no crisis addressed by the IEA has been caused by the OPEC ‘bogeyman’.\(^75\) Currently there are thirty IEA, or OECD member states,\(^76\) and the IEA essentially remains an agency for compiling data and making forecasts on energy markets.

### Companies

Besides oil exporting and importing governments, oil companies are the other major actors in the contemporary oil industry. Oil companies are divided into two major groups: the IOCs and the NOCs. The IOCs are further divided into majors and independents. Below, I firstly examine the IOCs and their major characteristics, what is followed by a survey of the NOCs. Moreover, both IOCs’ and NOCs’ interests and objectives are identified and discussed.

#### IOCs

The IOCs, which are also referred to as the majors or ‘Big Oil’, have a significant proportion of the exploration, oil and gas producing, oil refining, chemical and marketing operations in several different countries.\(^77\) Most IOCs strive to be vertically integrated economic actors specifically

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\(^71\) Relationships between the consuming nations are discussed in Lieber, *The Oil Decade*.


\(^76\) These are: Australia, Austria, Belgium, Canada, Czech Republic, Denmark, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Italy, Japan, Luxembourg, Mexico, Netherlands, New Zealand, Norway, Poland, Portugal, Slovakia, South Korea, Spain, Sweden, Switzerland, Turkey, United Kingdom, and USA.

and essentially involved in three highly capital-intensive activities: exploration for and production of crude oil (‘upstream’); transportation and refining of the same; and marketing of finished oil products (‘downstream’). In the past, this has resulted in great structural power accruing to the companies and enhancement of this position was possible by individual companies cooperating to maintain their market position. Consequently, free market principles have never fully applied in the oil industry and instead oligopoly has been the typical and usually accepted structure. While historically, vertical integration helped companies to absorb the burdens of adjustment between supply and demand, and assisted in shifting these burdens onto other actors, today, and generally after nationalisations of the 1970s, no private oil companies were/are operationally vertically integrated, and hence all are operationally imbalanced.

The majors are, as the term suggests, the biggest private oil companies. Nowadays, six corporations are regarded as majors: Exxon Mobil, Chevron, BP, Royal Dutch/Shell, Total, and ConocoPhillips. Between them, they account for roughly 13 percent of world oil production, 21 percent of refining, and 35 percent of product sales. Traditionally, majors were very powerful actors in the international political economy and have often been more powerful than some states, as their revenues were regularly higher than those of many small and medium sized states. In recent years, the IOCs have represented half of the world’s top ten MNCs by sales and profits, and half of top ten performing companies listed in S&P 500 index. As a group, the five major companies represent more than 50 percent of the market capitalisation of all publicly traded oil stocks, and during the past 20 years, these corporations have generated returns 10 percent higher than the industry average. In 2005, Exxon Mobil was world’s largest company in...
terms of sales, market value and profits, and its profits were larger than that of any U.S. company in history.

The independents are the late entrants, smaller, privately owned companies such as Anadarko, Valero Energy, Amerada Hess or Occidental without the same extensive vertical integration outlined above. The ability and willingness of these independents to employ spoiling tactics by offering host states more favourable terms than the majors was to prove a crucial variable in breaking the power of the latter to control the market after 1970. As a result when the OPEC challenge was made to wrest control from the majors, the presence of the independents assisted OPEC and weakened the majors. Today, outside their home countries, the interests of independents are mostly confined to one or two countries, and they have scant refining and marketing operations.

The IOCs are usually driven by three major interests before and after they established operations in a particular host state. Firstly, they seek a contract that allows them to ‘book’ these reserves – including them in their accounts – which increases the market value of their company. Production sharing agreements (PSAs), joint ventures (JVs), and royalty/tax (R/T) agreements, like concession contracts in past, permit companies to book reserves in their accounts. The importance of this should not be underestimated for the oil majors. In 2004, when Royal Dutch/Shell overstated the size of its ‘booked’ reserves by over 20 percent, it lost the faith of the financial markets: the company’s share price dropped and its credit rating fell.

Secondly, if unsurprisingly, before investing in a country, the IOCs look for an opportunity to make large profits. Generally, oil companies make their profits from investing and risking their capital, and they are usually high-risk takers. In some cases, they lose their capital, for example, when they drill a ‘dry well.’ However, in some cases they will find large and hugely profitable fields. Oil companies are therefore very different from service companies like Halliburton or Schlumberger, which make money from fixed fees on predictable contracts. IOCs aim for deals which may be more speculative, but which give them higher potential profit margin. A related objective is to maximise the long-run earnings of their stockholders. In this respect, adequate rates of return on private investments in developing countries are usually set above those found in developed countries. The difference represents a premium to cover perceived higher risks. Profit maximisation cannot be achieved through a strategy of pushing for growth in quantity of crude oil or products sold without due regard for price-cost (profitability) considerations. It can also come through vertical integration, economies of size, diversification, creation of additional capacity, as well as through the merger of competing or complementary oil companies.

Finally, the IOCs look for predictability of tax and regulation. While companies can accept exploration risk (that they will not find oil) or price risk (that the oil price falls), both being largely

beyond their control, they try to manage ‘political risk’ (that the host state will alter the fiscal and regulatory regime affecting their investment) by locking in governments. They thus seek to bind governments into long-term contracts that fix the term of their investment. PSAs, for example, last for 25 to 40 years with terms which protect the IOCs from potential change by incoming governments.

Other objectives of private oil companies relate to concerns over sales growth, raising market shares, and reducing uncertainty in the business environment. In their efforts to satisfy these objectives, oil companies often have command over or access to vast resources and wide opportunities as compared with a large number of host country governments, and notably the developing and low developed countries. The strength of IOCs has historically been based on not only their size and resources, but also their advanced technology and expertise; their superior organisational and managerial ability; their extensive market outlets; and their negotiating, or bargaining skills. Historically, and prior to nationalisations in many oil-exporting countries, these factors have favoured the IOCs in bilateral negotiations with low developed and developing countries.

As to their relations with oil-exporting countries, currently, in the best-case scenario, the activities of IOCs in oil sectors of countries with nationalised oil industries are mainly restricted to exploration, production and the export of crude. The sheer size of the oil assets controlled by the NOCs and their governments and the lack of alternative sources of crude oil is a large incentive for the IOCs to cooperate with oil-producing governments.

**NOCs**

An NOC “is a company with at least 51 percent state ownership that is active in the exploration and production of hydrocarbons – in other words the ‘upstream’,” and most NOCs were established by nationalisation and expropriation. Today, there are more than 100 NOCs around the world – one from almost every oil-exporting country and a number from major importing countries. Examples of majority state-owned or controlled NOCs are Kuwait Petroleum Company (KPC), Sonatrach of Algeria, Petroleos de Venezuela (PdVSA), Saudi Aramco, ADNOC of UAE, Pemex of Mexico, NIOC of Iran, the China National Petrochemical Corporation (Sinopec), the China National Petroleum Corporation (CNPC/PetroChina) the China National Offshore Oil Corporation (CNOOC), India’s Indian Oil Company (IOC) and Oil and Natural Gas Corporation (ONGC), Statoil of Norway, Gazprom and Rosneft of Russia.

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87 Marcel, *Oil Titans*, p. 5.
Petronas of Malaysia, or Petrobras of Brazil. According to Valérie Marcel, 90 percent of the world’s oil reserves are entrusted to state-owned companies.

For many oil-exporting countries, especially the member countries of OPEC, the nationalisation of the oil industry is an assertion of national independence. The governments of oil-producing countries establish NOCs with mixed objectives. The main reasons for formation of NOCs are revenue collection, preservation of sovereignty, and ideology. In most cases, an NOC is established to carry out all activities related to the oil industry in the country. An NOC has traditionally been regarded as the most appropriate instrument to develop the relevant technical and commercial expertise, partly in order to enhance their bargaining position in relation to the IOCs. It was rightly assumed that the IOCs have international interests that may not coincide with national interests whereas a NOC can be assumed to put national interest first. The governments opted to monopolise the sector or, in countries where IOCs were allowed a certain presence in the oil sector, the NOCs were given market power. The desire to bring the assets of the IOCs under state control was also led by the long history of political and economic exploitation. Despite large potential benefits to be gained from developing a NOC, after nationalisation, the NOCs often found themselves grappling with major problems, such as the lack of capital, and the lack of managerial and technological expertise.

NOCs can be distinguished between those set up by oil exporting countries and those set up by oil importing countries. Although from country to country, there are considerable differences between NOCs themselves and their relationship with their respective governments, there are many common aspects. Although the relationship between the NOCs and the state varies among the OPEC and non-OPEC countries, state interference is considerable and the oil-producing governments very often meddle with the management of the company and impose non-commercial demands. Governments control their NOCs through policymaking, which includes setting targets and industry rules, and by developing institutions, which hold the NOC responsible for its performance. Usually, NOCs are not consulted on key oil policy decisions, for example on those related to OPEC politics and policy. In some countries, the NOC is the only operator in the sector, whereas in other countries, the NOC always has a majority stake in a project, and/or arranges PSAs. In many oil-producing countries, the NOC, operating as the government’s agent, determines or biases entry, particularly through the administration of PSAs.

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89 In addition, some companies are partly state-owned. Examples are Inpex of Japan (38 percent government owned), Lukoil of Russia (7 percent government owned), or ENI of Italy (30 percent government owned). While Petrobras of Brazil is only partly state owned (32 percent), it has majority government shares at the voting level. Ibid, p. 6.
90 Marcel, Oil Titans, p. 1.
92 Noreng, Crude Power, p. 45.
98 Marcel, Oil Titans, pp. 76 and 80. For more detail, see chapter 4 in Oil Titans.
or through serving as a contractor with private IOCs. Domestic distribution of oil products, albeit below cost, is reserved for the NOC. Increasingly, NOCs are becoming vertically integrated companies (PDVSA, Saudi Aramco, Sonatrach, or CNPC) and compete with major IOCs internationally, thus blurring the distinction between the various categories.

Due to high level of government interference, NOCs have non-commercial objectives that differ greatly from those of the private IOCs. These objectives include wealth creation for the nation and oil wealth redistribution to society at large; foreign and strategic policy and alliance building; energy security, including assurance of domestic fuel supply and security of demand in importing countries; participation in national-level politics; and industrialisation and economic development.99

The structure of power between the oil companies is now tripolar. The majors are no longer able to set production and pricing targets as in the past. The independents are important, particularly in ‘downstream’ operations. The nationals represent a resurgence of state-centred attitudes and a desire to counterbalance the archetypical MNC represented by the majors. In recent years, they accounted for at least three-quarters of all production and worldwide oil reserves, clearly replacing the pre-OPEC domination of the majors.

In summary, the world’s oil industry can be characterised as a mixed actor model. There are a number of key actors but none is evidently predominant. Cooperation depends essentially upon an agreement about ground rules, which may be impossible if parties are pursuing mutually exclusive goals. It would be unrealistic to leave the impression that objectives and interests are uniform or necessarily consistent for all members of each group in the oil industry. Variances have existed and continue to exist among oil companies, as well as between oil exporting or importing governments. The changes in the split of benefits and costs among the major protagonists in the oil industry have crucial effects, and such changes lead to bargaining

1.2.2 The Contemporary Oil Industry: From Cooperation to Conflict

After identifying the major oil industry actors and their interests, it is essential to characterise the contemporary oil industry. In essence, the oil industry is an industry in which, typically, large economic rents can be earned because the market price is well above the price required to keep the factor in its present employment.100 Bargaining and negotiation determine the division of these rents. Bargaining among the major actors in the oil industry is not a new phenomenon, and while at any period of time there is bargaining, some periods, such as the 1970s and early 1980s can be classified as conflictual as


there was a high degree of bargaining, and other periods, such as the late 1980s and 1990s can be referred to as cooperative due to lower levels of bargaining.\textsuperscript{101}

The 1970s and early 1980s were the years in which oil produced for the international oil market was progressively brought under state control. The IOCs lost control of numerous ‘sweetheart’ deals with oil exporting governments, and in this period their initial bargains have obsolesced.\textsuperscript{102} In contrast, the late 1980s and 1990s showed a contrary development, as the oil industry experienced both deregulation and privatisation.\textsuperscript{103} The oil price fall in 1986 and the continued lower oil prices in the years thereafter unleashed a move away from the indebted state.\textsuperscript{104} Therefore, some states privatised their oil industries/companies, such as the UK, Brazil, Argentina, Italy and France. Other countries did see the need to at least commercialise state oil companies, and transform them into ‘normal’ companies.\textsuperscript{105} Since government control has become less direct, NOCs tried to redefine their roles, what at occasions put them at odds with their governments (for example Venezuelan government versus PDVSA). A major boost in the privatisation of NOCs in the oil industry came in the early 1990s, when centrally planned economies started on a process of transition towards market economies.\textsuperscript{106} The fragmentation of the Soviet Union into separate states and their painful transition to a market-based economy opened up the oil sector for private investment.\textsuperscript{107} In addition, in the 1980s and 1990s, most OECD governments increased oil taxes and captured increasing percentage of economic rent, away from producer governments. Arguably, the IOCs, after a period of 20 years, were again playing a dominant role in the international oil industry, as their control over market had increased, and joint ventures, strategic alliances and mergers had served to balance risk and control.\textsuperscript{108}

Thus, in the oil industry, resource nationalism and the ‘obsolescing bargain’ of the 1970s have weakened by the mid and late 1980s and 1990s. Oil expert Edward Morse argued that in the 1990s “resource nationalism has practically disappeared from the discourse of international relations.”\textsuperscript{109} In line with general trends and with low oil prices in the 1990s various oil-exporting states offered relatively attractive deals to the major Western IOCs, although we did not witness the return to the concessions era. The reopening of reserves to external companies has taken different forms in different countries, and terms on which foreign oil companies invested in host countries varied considerably, from royalty/tax system, which was most favourable to the IOCs, to PSAs, and risk service agreements, which were least favourable for the IOCs. In the 1990s, host countries needed the investment, and IOCs wanted access to oil, but only if it were cheaper to produce than it would be elsewhere. The underlying factors influencing bargaining in the oil industry in the second part of the 1980s and in the 1990s, was that the low oil prices resulted in host countries’ dire need for foreign investment; secondly, the IOCs had no challenging competition which would offer host countries more options; and thirdly, the IOCs still had alternative options to pursue if not allowed entry under favourable terms to a particular host state. While in the 1980s and 1990s bargaining did not disappear from the oil industry, it mainly

\textsuperscript{101} By ‘conflictual’, I do not imply military conflict, but rather a state of disharmony between actors with incompatible interests.

\textsuperscript{102} The concept ‘obsolescing bargain’ was initially framed by Raymond Vernon in Sovereignty at Bay, (see particularly pp. 47-53). It is explored in more detail in Chapter 2.

\textsuperscript{103} Stevens, Strategic Positioning in the Oil Industry, p. 13.

\textsuperscript{104} van der Linde, The State and the International Oil Market, p. 7.

\textsuperscript{105} Ibid, p. 8.


\textsuperscript{107} Hartshorn, Oil Trade: Politics and Prospects, p. 276.

\textsuperscript{108} van der Linde, The State and the International Oil Market, p. 8.

occurred between various oil exporters, and not between oil exporters, and oil importers and IOCs.\textsuperscript{110}

However, the oil industry has shifted from a cooperative phase during the 1990s, when the IOCs managed numerous ‘sweetheart’ deals, to a conflictual phase characterised by resource nationalism in the current decade. Hence, host state (and NOC)-IOC bargaining is frequent in the oil industry, and the stage seems set for competition between IOCs and NOCs over markets as well as upstream positions. As opposed to the common perception, I believe that the IOCs, although they sometimes may be supported by their powerful home (oil importing) states, do not gain extra bargaining power as they did in the 1990s. My assumption is that they have possibly lost it to NOCs from other oil importing states, such as China. Thus, the IOCs find themselves in a particularly challenging situation.

The Challenges Facing the IOCs

The major IOCs find themselves in a difficult situation. At first glance, it is hard to believe that major IOCs may be facing difficult times ahead when one takes into account that Exxon Mobil has been reporting the largest earnings in the history of business, notching up $8.4 billion in its first quarterly report of 2006. The combined 2006 earnings of Exxon Mobil, BP, Royal Dutch/Shell, Chevron, Conoco Phillips and Total, equal $135 billion, a sum greater than the GDP of the Czech Republic or Israel.\textsuperscript{111} Why would one need to be concerned about their future?

Today, the oil industry faces challenges that could ultimately wipe out some, or most of major IOCs, once venerated as the Seven Sisters.\textsuperscript{112} The biggest companies and remnants of the original seven may be running out of good ways to invest their money. Although cash-rich due to recent years’ surge in the oil price, these companies are opportunity-poor as their aging reserve base badly needs topping up (see Table 1.4),\textsuperscript{113} and they will all begin seeing production declines by 2009.\textsuperscript{114} This is not surprising when considering that they have been unable to replace their reserves in recent years (Table 1.4).\textsuperscript{115} In the oil industry, “reserve replacement is the best guide to whether a company will be able to maintain – or grow – production in the future.”\textsuperscript{116} At the same time, according to Robinson West, PFC Energy Chairman, “It is becoming increasingly difficult to find attractive ways to reinvest today’s profits,” and it will not get easier, since there are no infinite numbers of prospects to drill.\textsuperscript{117} A healthy reserve replacement ratio should always be over 100 percent. However, ratios for most of the six major IOCs have lately been below that level, and will remain there over the next five years.\textsuperscript{118} Buried beneath their record profit figures of recent years are worrying signs of a sector in decline. Analysts from McKinsey and Company consultancy have suggested that “Big Oil confronts its most far reaching test in decades,” as “the top five companies – Exxon Mobil, BP, Royal Dutch/Shell, Chevron and Total – face

\textsuperscript{111} “Why You Should Worry About Big Oil,” Business Week, May 15, 2006.
\textsuperscript{112} “A Survey of Oil,” The Economist, April 30, 2005, p. 8. Seven Sisters originally included Esso, Gulf, Texaco, Mobil, Chevron, BP and Shell.
\textsuperscript{113} “A Survey of Oil,” p. 8. That is particularly true in North America and the North Sea, which account for about 60 percent of the majors’ current oil and natural gas production and where more than 50 percent of the reserves have been extracted. In those areas, production costs continue to climb, and every new investment to extend the life of the reservoirs becomes more marginal, as fixed costs are covered by shrinking volumes. In the North Sea, for instance, the average extraction cost for a barrel of oil rose 42 percent from 2000 to 2005. Bozon, et al. “What’s Next for Big Oil?”
\textsuperscript{115} “A Survey of Oil,” p. 10.
\textsuperscript{116} Schwartz, “A Shell of Itself.”
\textsuperscript{117} Quoted in “Why You Should Worry About Big Oil.”
\textsuperscript{118} Ibid.
increasingly tough challenges finding new sources of oil and natural gas to replace existing reserves.\textsuperscript{119}

Table 1.4: Major IOCs’ Crude Oil and Natural Gas Liquids (NGL) Reserves (2002-2005)

<table>
<thead>
<tr>
<th></th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Exxon Mobil</td>
<td>12,623</td>
<td>12,856</td>
<td>11,651</td>
<td>11,229</td>
</tr>
<tr>
<td>BP</td>
<td>7,762</td>
<td>7,449</td>
<td>7,550</td>
<td>7,161</td>
</tr>
<tr>
<td>Total</td>
<td>7,231</td>
<td>7,323</td>
<td>7,003</td>
<td>6,592</td>
</tr>
<tr>
<td>Chevron</td>
<td>6,494</td>
<td>6,280</td>
<td>5,511</td>
<td>3,626</td>
</tr>
<tr>
<td>Royal Dutch/Shell</td>
<td>5,782</td>
<td>5,009</td>
<td>3,745</td>
<td>3,466</td>
</tr>
<tr>
<td><strong>Total Majors</strong></td>
<td><strong>39,892</strong></td>
<td><strong>38,917</strong></td>
<td><strong>35,460</strong></td>
<td><strong>32,074</strong></td>
</tr>
</tbody>
</table>


While the major IOCs may be generating unprecedented profits, this comes with a cost, as between 2000 and 2006 their returns on capital have been stagnant. According to Goldman Sachs, in 2006, the average integrated Western oil company will earn a 19 percent return on capital employed, up by only 2 percent since 2000.\textsuperscript{120} In the supremely capital-intensive oil industry, return on capital is a key measure because it reflects not just how much profit a company made, but the cost of making it. The bottom line is that value creation at oil companies is stagnating. While IOCs are making more than ever before, they are also spending unprecedented amounts to generate those profits. In addition, they are struggling to find where to put their profits safely and soundly to work in order to increase their return on capital. Overall production at the oil majors is struggling to keep up with demand, and as argued above, the reserve replacement ratio, the measurement of how well they are replenishing their supplies, is slipping.

The biggest obstacle the majors face in replacing their reserves is the ultimate peculiarity of the oil business. Oil is the only industry in which the cheapest to produce oil reserves and largest assets, those located in Russia and OPEC countries, are not in the hands of the most efficient and best-capitalised firms, Western IOCs,\textsuperscript{121} but of NOCs,\textsuperscript{122} where in most cases the government owns and self-finances the whole operation from reserves to pipelines – the “Saudi Aramco model.”\textsuperscript{123} In numerous countries, foreign investment in energy exploration and production (‘upstream’) activities is banned or saddled with strong disincentives.\textsuperscript{124} Although some claim that despite the existence of “some holdout governments that refuse to relinquish control to the private sector,” resource nationalism is moribund,\textsuperscript{125} this does not apply in the oil industry, where oil producing and exporting states own and control \textit{at the very least three-quarters} if not 90 percent of total proven world oil reserves.\textsuperscript{126}

\textsuperscript{119} Bozon, \textit{et al.}, “What’s Next for Big Oil?”
\textsuperscript{120} Rana Foroohar, “Big Oil’s Big Problem,” \textit{Newsweek}, October 9, 2006, p. 40.
\textsuperscript{121} No major oil companies in top 50 companies in the world by assets in 2006. “The Forbes Global 2000.”
\textsuperscript{122} “A Survey of Oil,” p. 10.
\textsuperscript{123} As opposed to the “Azerbaijan model,” in which the state-owned assets are operated, managed, funded and equipped almost entirely by the oil MNCs under production-sharing agreements (PSAs), in exchange for a percentage of sales receipt. Greg Palast, “OPEC on the March,” \textit{Harper’s Magazine}, April 2005, p. 76.
\textsuperscript{124} Klare, \textit{Blood and Oil}, p. 123. The Middle Eastern countries serve as a typical example.
\textsuperscript{125} Morse, “A New Political Economy of Oil?” p. 18.
Thus, the problem for major IOCs is not that there is not enough oil, but that there are not enough opportunities to find oil. For example, two-thirds of the wells drilled worldwide from 1997 to 2003 were in North America, where production is falling. Meanwhile, the Middle East, which holds two-thirds of the world’s proven reserves of conventional oil, accounted for only 2 percent of global investments, and has ever since the nationalisations that took place three decades ago remained largely off limits to international investors. Much of the majors’ production today comes from large fields in Alaska, the Gulf of Mexico and the North Sea, which are in the phase of rapid decline. Desperate major IOCs are now looking for growth in West Africa, the Caspian, Venezuela, Russia, Canada’s tar sands and the ultra-deep waters off Brazil. Nevertheless, this new wave of oil exploration is proving difficult and dangerous due to some countries’ complex oil formations and unforgiving environments that require lots of up-front capital expenditure, and mostly due to unreliable legal frameworks and political risks associated with investing in many of these countries.

Major IOCs also face increasing competition. NOCs have grand ambitions: they are competing with the majors by developing new oil reserves overseas and investing in international refining and retail activities. The technology, the capital and the markets, the lack of which was often seen as a reason to private NOCs, are now easily available through independent operators (Talisman Energy and Apache for example) and oil-service companies (Halliburton and Schlumberger), but more importantly, from NOCs from oil importing (China, India, Brazil) and exporting countries (Malaysia’s Petronas, Norway’s Statoil) who are expanding internationally. To illustrate, competition for untapped energy deposits with NOCs from China and India has been described as “fiercer than ever”.

Thus, it is not surprising to see that the top nine companies in the world’s list of top twenty oil companies by reserves are fully state-owned, and Exxon Mobil is fifteenth, the top ranked major. Moreover, besides low reserve ownership of 2.7 percent of the world total, the majors in 2005 produced only 39 percent of their sales volume, and just 13-15 percent of global oil production. Major Western IOCs as a whole have full access to countries with only 6 percent of the globe’s known reserves, mainly in North America and Europe, and can also invest in countries that own additional 11 percent of reserves through JVs or PSAs. It is worth mentioning that as late as 1972, the ‘Seven Sisters’ controlled 91 percent of Middle Eastern production and 77 percent of the non-communist world’s oil reserves outside the United States. According to Oystein Noreng, until about 1970, integrated trading represented perhaps 85-90 percent of international oil trade. In the past, major IOCs – with their leading-edge controlled by partially privatised Russian oil companies. See “The Changing Role of National Oil Companies in International Energy Markets,” p. 1.

127 Quoted in Mouawad, “Big Oil’s Burden.”
129 For example, Royal Dutch/Shell’s Sakhalin-2 project and BP’s Thunder Horse platform are extremely expensive to build and dangerous to maintain.
131 Bozon, et al. “What’s Next for Big Oil?”
132 Petroleum Intelligence Weekly.
135 Data from PFC Energy, a Washington-based consulting firm, consulted in Jad Mouawad, “Western Firms Feel a Pinch from Oil Nationalism,” International Herald Tribune, May 7, 2006
137 Noreng, Crude Power, p. 164.
technology, unrivalled expertise in managing complex projects, and deep pockets had a clear edge in negotiations with the national governments in control of energy resources. However, as evident, those advantages have become less pronounced, thus weakening their position at the negotiating table. In addition, the loss of supply base following nationalisations subsequently reduced the volume and significance of integrated trading.

In order to maintain their status as the world’s top MNCs, major IOCs need to ensure possession of more oil reserves. This is certainly not going to be easy and may require much help from their home states and skilful bargaining with oil producing states and their state-owned companies. The rise of the NOCs and resource nationalism ensures that the major IOCs will not have cheap and easy ‘sweetheart’ deals in future. Edward Morse argued in 1999 that the new era in the political economy of oil is marked by “a shift from government control to government and industry cooperation,” and that “resource nationalism … disappeared from the discourse of international relations.”

The evidence presented above points quite to the contrary.

Conclusion: Empirical Conundrums

This chapter has shown that the market for the most important strategic commodity in the world is politicised. Such characterisation is derived from the premise that governments interfere in the free functioning of the international oil market. This does not imply that the economic factors are less important, but it does suggest that the economic and political factors deserve equal attention. Since the international oil market is politicised, studying bargaining relationships between various oil industry actors is the most effective way of understanding it. Given that bargaining between various actors shapes the political events, bargaining between different actors in the oil industry shapes the politics of oil. Thus, studying bargaining is crucial for understanding the balance of power between major actors in the contemporary oil industry.

Various oil industry actors - oil exporting and importing governments, the IOCs, and the NOCs – have diverging objectives and interests. Both intra and inter-group interests are generally not uniform or consistent. Variances have existed and continue to exist among oil companies, as well as between oil exporting and importing governments. For example, while oil importing countries’ main objective is to ensure secure oil supplies at reasonable prices, the IOCs’ main goal is profit maximisation. The oil industry is currently in a conflictual stage, which differs from previous cooperative stage that lasted throughout the late 1980s and the 1990s. In the current stage, resource nationalism is rampant and there is a lot of evidence of bargaining. Despite their record-breaking profits the major IOCs are struggling to compete with oil exporting countries and NOCs from both oil exporting and importing countries. This may suggest that, similar to unfavourable developments, such as expropriations and nationalisations that they faced in the 1970s and the early 1980s in many oil exporting countries, the attractive deals that the major IOCs signed with oil exporters in the late 1980s and 1990s may not remain in tact for much longer. In other words, their bargain may be re-obsolescing, and thus, oil exporters and their NOCs may to be on the winning end of the contemporary oil industry bargain.

Meanwhile, energy security has re-emerged on the top of the agenda for most of the oil importing governments. In the 1970s, particularly during the two oil crises, major oil importing governments considered the availability of sufficient oil supplies as the paramount objective since oil formed the backbone of their economies. We can witness a similar situation in the recent years, and various oil importing governments have adopted diverse approaches in tackling the problem. Historically, the U.S., the world’s largest oil consumer and importer, has been faithful to the markets, and largely relied on ‘its’ and other IOCs to supply its oil market, without exercising direct control over American IOCs. However, other countries, and particularly the

world’s second largest oil consumer – China – do not share the same faith in the markets. After it became an oil importer in 1993, China supported and directed its NOCs in order to secure the delivery of oil supplies to its shores. The Chinese government’s financial and diplomatic support for its NOCs may be one of the most significant contributors to the demise of the IOCs, since the latter most likely lack such unconditional home government support. China’s diplomatic and financial support for its NOCs is driven by China’s insatiable thirst for oil. This, in turn, may endow the governments of countries from which China sources its oil with increased bargaining power vis-à-vis the potential investors and other actors, and these governments are likely to use their increased bargaining power as a leverage in order to gain concessions in other bargaining arenas.

Several questions emerge based on these preliminary empirical observations. Have the major IOCs in the current decade lost their bargaining power vis-à-vis oil exporting governments and their NOCs, when compared to the late 1990s? If so, is this indicative of their ultimate demise, which began with nationalisations and the ‘obsolescing bargain’ in the 1970s? In other words, are we witnessing the ‘re-obsolescing bargain’? The preliminary survey of the contemporary oil industry points in this direction, and suggests that the increased competition from NOCs is the main factor influencing diminished IOC bargaining power. However, whether this indeed is the case warrants a much more detailed and thorough analysis. If the IOCs’ bargain is indeed re-obsolescing in this decade, are the oil exporting countries and their NOCs the main beneficiaries? Are any other actors, such as China’s NOCs, also reaping benefits at the IOCs’ expense? If China’s NOCs’ bargaining power is increasing at the IOCs’ expense, is the world’s largest oil importer, the United States, stepping behind ‘its’ IOCs and supporting them in their bargaining with other oil industry actors? If there is such help, does it improve IOCs’ chances of bargaining success? If oil exporters are successful in bargaining with major IOCs, and if they are endowed with increased bargaining power vis-à-vis other actors, are they also able to gain concessions by using oil as a bargaining chip in other arenas? Finally, given that various governments adopt different strategies in order to secure their oil supplies in this new age of energy security, are the governments of major oil importing countries successful in bargaining with other actors when their oil supply security is perceived as threatened? Answering these questions is the main focus of this book. In order to answer them, in the following chapter I analyse various previously established and directly relevant theoretical debates and frameworks, and set up the hypotheses to be tested later in the this dissertation.
EXTANT LITERATURE AND HYPOTHESES

Introduction

The central task of this book is to examine whether due to their weak relative bargaining power, the IOCs have been on the losing side in their bargaining with oil exporting countries and/or their NOCs in the current decade when compared to the late 1990s. If this indeed has been the case then we are witnessing the return of the obsolescing bargain, and one of the tasks will be to outline the major factors contributing to such dismal state of affairs for the IOCs, and assess whether they can rebound and resume some of their past glory in the international oil industry. Moreover, besides possibly gaining bargaining power vis-à-vis IOCs, I will also test whether the oil exporters, by using oil as a bargaining chip, are able to gain concessions and achieve their goals in other bargaining arenas, and whether the governments of major oil importing countries, such as the U.S., Japan, and China, achieve bargaining success vis-à-vis other actors even if their oil supply security is perceived as threatened. In addition to oil exporting countries and their NOCs, who may be the main beneficiaries of the IOC demise, China’s NOCs may also be gaining bargaining power at the expense of the IOCs, and this will also be tested. If this were the case, it would certainly not be surprising given China’s insatiable thirst for imported oil, and its competitiveness and adoption of non-market measures in obtaining secure access to it. The U.S., the world’s largest oil consumer and importer, has historically been faithful to the markets and this, in turn, may not be helping ‘its’ IOCs. I will test whether the common perception that American IOCs are backed up by the U.S. government is indeed the case. I will also test whether American IOCs’ interests are exclusively aligned with the U.S. government’s interests, and whether American IOCs receive help from the U.S. government in bargaining with other actors. Finally, if they do receive support, I will test whether this support results in successful bargaining outcomes for American IOCs.

Answering these questions will advance both our empirical and theoretical understanding of the oil industry and bargaining literature in a number of ways. First, it will enable us to assess whether we are going to witness further decline, if not the end, of ‘Big Oil’, and if there is a way in which the major IOCs may rebound from their current lows. Second, we will be able to analyse which exact factors, if any, are to be blamed for IOC decline. Third, the bargaining model I establish in order to assess temporal variation in IOCs’ bargaining power vis-à-vis host states will upgrade the obsolescing bargain model, and may be useful in testing temporal variation in bargaining power among MNCs and host states in various extractive industry scenarios. Fourth, answering these questions will assist us in furthering our understanding whether, by using oil as a bargaining chip, oil exporters are able to gain concessions from actors in other bargaining arenas. If this indeed is the case, then we may be able to make an informed guess on whether, under current market conditions, Iran may be able to continue its pursuit of nuclear technology, and whether Hugo Chávez may be able to successfully spread his Bolivarian Revolution to the rest of Latin America. Fifth, by assessing the relationship between the U.S. government and American IOCs, and how this relationship translates in bargaining outcomes for American IOCs, it will enable us to either verify or disprove the ‘urban myth’ which assumes
close connection between the U.S. government and Big Oil, and will also further our theoretical understanding of home government-corporate relationship. It may also lead us to assess whether the U.S. government can, and should bail out American IOCs if they are in decline. Sixth, examining whether governments of major oil importing countries are successful in bargaining with other actors when their oil supply security is perceived as threatened will help us understand their actual bargaining power vis-à-vis oil exporters and other actors in both domestic and international politics. Finally, if we find that China’s NOCs are indeed gaining bargaining power vis-à-vis the IOCs, it may lead us to suggest that nationalisation, or at least closer home government-corporate alliance may be the best way forward to salvage IOCs.

In this chapter I propose a number of hypotheses to be tested in this dissertation. Some of these hypotheses are based on previous theoretical assumptions, and if this is the case, the relevant literature is reviewed. However, since the literature on bargaining in the oil industry is very limited, some of the hypotheses are exploratory and thus based on common logic, rather than on previous theoretical assumptions and/or empirical findings. I begin the chapter by surveying the host state-MNC bargaining literature. Surveying this literature is paramount in order to examine whether due to their weak relative bargaining power, the IOCs have been on the losing side in their bargaining with oil exporting countries and/or their NOCs in the current decade when compared to the late 1990s, and thus, whether the IOCs are facing the return of the obsolescing bargain. This is followed by review of the literature on the relationship between home states and ‘their’ MNCs, which is essential in analysing the relationship between American IOCs and the U.S. government. Then, I discuss the rise of China and the new age of energy security, which sets the appropriate background for assessing whether China’s NOCs may be gaining bargaining power at the expense of the IOCs, and also whether the governments of major oil importing countries, such as the U.S., Japan, and China, achieve bargaining success vis-à-vis other actors when their oil supply security is perceived as threatened. Finally, I elaborate on the concept of ‘issue linkage’ which is paramount in helping us to understand how bargaining in the oil industry is not isolated, but is ‘nested’ within other bargains, and thus, testing whether the oil exporters, by using oil as a bargaining chip, are able to gain concessions and achieve their goals in other bargaining arenas.

2.1 Host State–MNC Bargaining

In order to gain a good understanding of bargaining between the MNCs and host states, one has to engage in theories presented by various international business scholars, since their studies, unlike those of political scientists and business scholars, focus on both actors. The main concepts from host state-MNC bargaining literature, such as Raymond Vernon’s ‘obsolescing bargain’, and Albert Hirschman’s ‘exit, voice and loyalty’ are of much utility for this study, particularly in addressing the central research question: If major IOCs appear to be on the receiving end in bargaining with other actors in the contemporary oil industry, is this indicative of their ultimate demise and thus are we witnessing the ‘re-obsolescing bargain’? Besides elaborating on these frameworks, below I introduce my own quantitative bargaining model with IOCs-specific resources variables and industry and country context variables as determinants of IOCs’ bargaining power vis-à-vis host governments, which is later used to test the first hypothesis, and thus compare IOCs’ bargaining power vis-à-vis host states in 1998/99 and in 2005/06. However, firstly I review the host state-MNC bargaining literature.

The Obsolescing Bargain
Conflicts between host governments and MNCs usually centre on the issues of division of benefits and extraterritoriality.\textsuperscript{139} How are these conflicts explained by academia? The policy of host governments towards MNCs – particularly those operating in the field of natural resources – has primarily been analysed in terms of a “bargaining model,” and originally developed by Charles Kindleberger in 1965.\textsuperscript{140} In what has become the classic formulation, Kindleberger conceptualised the relationships between MNCs and the host governments with regard to foreign direct investment (FDI) as one of “bilateral monopoly”, one buyer and one seller of a foreign investment project:

In a typical situation, a company earns more abroad than the minimum it would accept and a country’s net social benefits from the company’s presence are greater than the minimum it would accept … with a wide gap between the maximum and minimum demands by the two parties.\textsuperscript{141}

Thus viewed, the outside limits of acceptability could be located by means of economic theory but the precise terms of the investment would be a function of the relative bargaining strengths of the two parties. Equilibrium analyses must give way to power analysis; economics to political science. “Bilateral monopoly” model,\textsuperscript{142} predominant in the 1960s and early 1970s ignored the role of domestic politics. A more dynamic explanation for lopsided power gain by host governments in the 1970s was an argument developed specifically for FDI in the natural resources sector – the concept of the obsolescing bargain, which grew out of early efforts by Edith Penrose and Charles Kindleberger.

This balance-of-bargaining-power approach has proved to be a useful conceptualisation in studies of relations between MNCs and the host governments of both developing and developed states to a lesser extent,\textsuperscript{143} and Raymond Vernon’s obsolescing bargain model (OBM) has occupied central stage in explaining these dynamics in the late 1970s, 1980s and early 1990s.\textsuperscript{144} OBM explains the changing nature of bargaining relations between an MNC and host country government as a function of goals, resources and constraints on both parties, and numerous authors from a wide ideological spectrum have endorsed this argument.\textsuperscript{145} In OBM, which is

\textsuperscript{139} Mikdashi, \textit{The International Politics of Natural Resources}, p. 147. Related sources of conflict may arise from the MNCs patronising suppliers and contractors outside the host country, dominating the domestic credit market to the detriment of the smaller, less resourceful local firms, refraining from ploughing back earnings into nationally desirable new activities, and refusing the joint participation of national capital and management.

\textsuperscript{140} In the early years, this approach has been advocated most explicitly by Charles P. Kindleberger, \textit{Economic Development} (New York: McGraw-Hill, 1965).


\textsuperscript{143} While Vernon applies the obsolescing bargain in its original form explicitly to developing countries, subsequent writers have expanded the theory to apply to developed countries (Canada and Australia) as well. For example, see C. Fred Bergsten, “Coming Investment Wars,” \textit{Foreign Affairs}, no. 53, October 1974, p. 139; C. Fred Bergsten, Thomas Horst, and Theodore H. Moran, \textit{American Multinationals and American Interests} (Washington, D.C.: Brookings Institution, 1978), p. 143; and John Richards and Larry Pratt, \textit{Prairie Capitalism: Power and Influence in the New West} (Toronto: McClelland and Stewart, 1979), p. 9.

\textsuperscript{144} OBM was first developed by Raymond Vernon in \textit{Sovereignty at Bay}, see particularly pp. 47-53.

seen as a positive-sum game in which the goals of the MNC and host state are assumed conflicting, the initial bargain favours the MNC, but as MNC assets are transformed into hostages, relative bargaining power rapidly shifts to the host state over time. Once bargaining power shifts to the host state, its government imposes more conditions, such as higher taxes or asset expropriation, on the MNC. Thus, the original bargain obsolesces, giving OBM its name. Originally applied as an explanation for widespread expropriation and nationalisation in the 1970s of MNC natural-resource subsidiaries located in developing countries, OBM was later tested in other situations such as manufacturing MNCs and developed host states, with much weaker results.

Thus, evidence emerged that MNCs have been able to protect their bargains. For example, Theodore Moran’s 1973 study of the Chilean copper industry found that the U.S. multinational Kennecott developed domestic and transnational alliances, which when the firm was nationalised by the Chilean government in 1971, were successful in getting Kennecott nearly full compensation for its investments. Anaconda, another U.S. MNC that had not developed any domestic alliances, was nationalised without any compensation. Moran concluded that resource-intensive industries could reduce the probability of an obsolescing bargain by reducing their own risk exposure and raising the costs to the host state of opportunistic behaviour. As a second example, Jenkins’ 1986 study of the National Energy Policy in Canada found that the IOCs were able to defeat Canada’s National Energy Program by enlisting the U.S. government on their behalf, shifting their oilrigs outside of Canada and cancelling new investments. In Multinational Corporations: The Political Economy of Foreign Direct Investment, Moran also provides several rich case studies. So do Kobrin and Grosse & Behrman in manufacturing industries, Vachani in studying nationalisations of foreign MNC investments by Indian government of US, British and European subsidiaries, and Bennet and Sharpe in their study of bargaining between the Mexican government and foreign automotive MNCs.

Historically, over half a century since host state-MNC relations have been on the research and policymaking agendas of countries around the world, this relationship has alternated between

References:


- Vernon, Storm over the Multinationals.
- Kobrin, “Testing the Bargaining Hypothesis.”
- Moran, Multinational Corporations.

Footnotes:

147 Kobrin, “Testing the Bargaining Hypothesis.”
148 Moran, Multinational Corporations.
cooperation and confrontation. Since the publication of Vernon’s Sovereignty at Bay, critics and promoters of FDI have converged on an explanation for these shifts in state-MNC relations. During the 1960s, with the exception of countries that were members of the socialist bloc, FDI was widely welcomed. Towards the end of that decade, governments in a number of industrialised countries began to exhibit concern with regard to the impact of FDI on the national economy. Among industrialised countries, increased foreign penetration in ‘strategic’ industries triggered a reaction. In developing countries, growing interest in regulating FDI was attributed to new social and political forces at the centre of economic and political decision-making that were favourable to a nationalistic approach to industrialisation, and to a host state’s learning process and the increase in domestic skills and confidence to which it had given rise. Hence, driven by nationalist goals and a changed perception of the contribution of foreign firms to the national economy, countries both in the developed (Australia and Canada) and the developing world introduced more restrictive policies towards FDI, and the number of nationalisations, particularly in the natural resource industries, increased dramatically over the 1970s. The adoption of a more nationalistic stance vis-à-vis foreign investors stimulated a wealth of analytical work on MNCs and their relationship to nation-states (see above).

However, according to John Dunning, relations between MNCs and host governments in developing countries changed from the 1970s, when they were “predominantly adversarial and confrontational, to being non-adversarial and cooperative” in the 1980s and 1990s. With greater overall acceptance of FDI in the developing countries and economies in transition, and privatisation replacing public-sector ownership at a rapid pace around the globe, it has been suggested that foreign investors in natural resources could come to be treated just like FDI in any other sector. This has been exacerbated by the fact that in the 1980s, liberalism became the dominant discourse under the Reagan and Bush administration in the United States, the long-lived Thatcher regime in the U.K. and surprisingly, with respect to FDI, under the socialist government of Francois Mitterrand in France. This change in government attitudes was accompanied by economic liberalisation, deregulation, privatisation, less expropriation, and the loosening of rules governing FDI – all of which created unprecedented opportunities for Western MNCs. Changes in investment legislation from the mid-1980s onward, became overwhelmingly favourable to the MNC. For example, one study identified only 11 cases of expropriation in the developing world from 1981 to 1992, compared to 83 cases in 1974 alone.

153 Lynn K. Mytelka, “‘We the People’: The Transformation of State-TNC Relations at the Turn of the Millennium,” Journal of International Management, vol. 6, 2000, p. 315.
155 See Moran, Multinational Corporations.
156 Mytelka, “‘We the People’”, p. 314.
The United Nations classified policy changes in developing countries as being either favourable or unfavourable to foreign investors: between 1991 and 2001, fully 94 per cent of the changes were classified as favourable to foreign investors. In addition, developed country governments were particularly active in the use of fiscal incentives for foreign investors. Data covering 26 OECD member countries over the period from the mid-1980s to the early 1990s showed that more of these countries were using a reduction of standard income tax rates, tax-holidays, accelerated depreciation, investment/reinvestment allowances, and deductions from social security contributions than in the past, and many of them had increased the range and importance of such incentives. In summary, the openness to FDI that characterised the 1980s and 1990s replaced nationalistic behaviour of the 1970s.

Thus, the now widely held view among international business scholars is that the OBM has outlived its usefulness and requires revision. The many case studies testing the model in the late 1980s and 1990s suggested that MNCs were able to retain relative bargaining power and prevent opportunistic behaviour by host states so the bargains seldom obsolesced. In addition, Eden and Lenway suggested that governments moved from regulating to encouraging entry, from taxing to subsidising, from opposition to FDI to partnership with multinationals. By opening and liberalising their economies in order to attract inward FDI, it is claimed that host states’ policies have shifted from ‘red tape’ to ‘red carpet’ treatment of foreign MNCs, and MNC-host state relations are now cooperative, not conflictual: “During the 1980s and 1990s, the pendulum swung in the opposite direction as MNE-state relations shifted from confrontation to cooperation.” Thus, “the 1990s have been characterised by a remarkable lack of state-MNC bargaining and overall stability and further liberalisation of foreign investment regimes at the national and international level.” Since the rules and regulations that govern FDI have become increasingly liberal and fixed, this has liberalised the investment climate to the extent that, arguably, there are now very few restrictions on FDI and even less opportunity for host state-MNC bargaining as governments are increasingly tied into a web of international commitments. Moreover, it is argued that MNCs now possess more bargaining power vis-à-vis

162 Of the 1,393 changes in FDI policy made from 1991 and 2001 in developing countries, only 78, or 5.59 percent were unfavorable to investors. See United Nations, World Investment Report 2002: Transnational Corporations and Export Competitiveness (New York: UNCTAD, 2002), p. 4.
166 Ibid, p. 385.
the former than they did three decades ago. Since little formal bargaining occurs between MNCs and host governments, many argue that there are few areas where OBM applies.

With the advent of globalisation, many theorists assert that bargaining no longer defines the MNC-host state relationship, and that the relative irrelevance of bargaining is reflected in a shift from a conflictive relationship to a more cooperative one. Governments and firms are viewed as increasingly interdependent in realising wealth and competitiveness in the global marketplace. "The key to the new [liberal] approach to TNCs [MNCs] is that policy on FDI and policy on endogenous growth have converged. TNCs are regarded as central to the creation and diffusion of knowledge, within and between firms, and in cooperation with Governments." In addition, the MNCs have been "the primary economic agent facilitating and benefiting from globalisation." I disagree with numerous claims that bargaining no longer defines the MNC-host state relationship, and that their relationship is currently cooperative. Even in a global liberalised world, bargaining still features prominently in host state-MNC relationship. In studying bargaining between Intel and the state of Israel in 2000, in which the latter, a small country, bargained successfully with one of the world’s largest and strongest MNCs, Tamir Agmon argues that despite globalisation, “national states are trying to generate as much welfare for their residents as they can, while MNEs try to maximise their value. This creates a bargaining situation,” since “the set of national states is the constraint in the maximising behaviour of the MNE.” In addition, Agmon argues, “In the world of international business, negotiation rather than the perfect market equilibrium solution is the rule.” Agmon’s suggestion is accurate as bargaining remains a primary way in which host states deal with MNCs, as long as there is potential for the MNC to reap extraordinary profits at the expense of a host state. Interests of MNCs and host states are remarkably different and often lead to conflict. As outlined in Chapter 1, this is clearly the case in the contemporary oil industry. The MNC is a profit maximising (rent-seeking) firm that measures success in terms of short-term return on investment in a complex marketplace comprised of many national states, each of which can exert a certain degree of monopolistic power within a certain location in order to create value for their residents. Politicians measure success in terms of popular support and/or re-election. The general problem of income distribution is caused by essentially conflictual interests between MNCs and host states even though some of their goals may be compatible.

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174 Tamir Agmon, “Who Gets What: the MNE, the National State and the Distributional Effects of Globalization,” *Journal of International Business Studies*, vol. 34, 2003, pp. 416-7. Agmon points that added value that stays in Israel does not benefit the shareholders of Intel, while benefits to the shareholders of Intel do not contribute to the welfare of Israel.


Given the inherent differences between MNC and host state interests, bargaining has not disappeared from the MNC-host state relationship, and therefore, the OBM may be revitalised when studying MNC-host state relations. Vernon himself perceived the openness of the 1990s (pro-FDI policies, liberalisation, deregulation, and privatisation) as “the calm before the storm”. Taking the anti-globalisation movement into consideration further supports this suggestion. Stephen Kobrin argues that MNCs are under attack by the anti-globalisation movement, to which some nation-states subscribe, which is evolving into a global organisation that could potentially threaten the continued liberalisation of the global economy.

Exit, Voice, and Loyalty

Since bargaining has not disappeared from host state-MNC relationship, and the relationship has been conflictual in the current decade, two frameworks will be used to determine whether MNCs’ (in my case, IOCs’) bargaining power has obsolesced. Firstly, I argue that if an issue over terms of agreement arises between host states and MNCs, in their bargaining with host states, by borrowing Albert Hirschman’s terms and analysis to a bargaining relationship, MNCs have three viable options – exit, voice, and loyalty (see Figure 2.1). Issues over terms of cooperative contract between host states and MNCs (and IOCs in particular) arise quite often due to “the inherent instability of any negotiated settlement.” For example, according to Matthew Bell, large-scale infrastructure concessions-contracts that are typically designed to last 15-30 years are renegotiated on average after only 2.1 years. In such situations, IOCs have an option to remain loyal and not engage in bargaining, or voice their concern regarding the issue in order to renegotiate the terms. After bargaining, the IOCs can either conclude a new cooperative agreement with the host state and maintain their operations in that country, or if the agreement was not reached exit the country altogether. Bargaining can include explicit negotiations, but can also occur tacitly, when parties attempt to influence each other informally without necessarily being conscious that they are in a bargaining relationship.

Figure 2.1: Exit, Voice and Loyalty in IOC-Host State Bargaining

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177 Vernon foresaw this in 1998. See Vernon, In the Hurricane’s Eye.
178 Ibid.
Options taken by IOCs tell us much about their bargaining power. If they wish to remain loyal and not to bargain, this indicates that their bargaining power is weak and they have no alternative options to pursue if they exit this particular host state. In other words, if they have low voice potential they also have low exit potential and vice-versa (see Figure 2.2). If they voice their concerns, it often shows that they do possess bargaining power vis-à-vis the host state and they can opt out in theory. This usually entails that they are able to pursue alternative options in other countries and under better terms than in this particular country; or that their operations are just not profitable anymore and there is no other option but to bargain. Hence, in this scenario, the IOCs often possess high voice and exit potential. Overall, the expected utility of voice option is grounded in their relative power capabilities. If they have higher bargaining power than the host state, the IOCs are more likely to succeed in voicing their concerns by renegotiating a better deal. However, it is important to note at this point that IOCs, just like mining MNCs suffer from a major structural vulnerability, what Theodore Moran refers to as the “hostage effect,” which is associated with large sunk capital. Thus, after investing heavily in a particular host country’s oil industry, IOCs, unlike manufacturing investors, cannot easily threaten to exit due to capital-intensive nature of oil extraction, which imposes high barriers to exit, even if the host state revises the bargain. Hence, this option will usually be the one of last resort.

Figure 2.2: IOCs’ Exit and Voice Potential Matrix

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Bargaining Model

The second framework that I use to measure bargaining power of the IOCs vis-à-vis host states (oil exporting countries) and their NOCs is presented below (see Figure 2.3), and is essentially an extension of the OBM. The *raison d’être* of the firm is the ongoing search for and sustainability of economic rents. In order for an IOC’s bargaining power to generate rents that are sustainable, the bargaining power must be based on idiosyncratic firm resources and capabilities that are valuable, rare, imperfectly imitable, and lack strategically equivalent substitutes. Additionally, the relationship between firm-specific resources and capabilities and bargaining power is moderated by industry factors and country-specific factors. Bargaining power is a mediator variable, as it facilitates the linkage between IOC-specific resources and the bargaining outcome. IOCs’ bargaining power is indicated by the nature and size of the ‘bargaining outcomes’ that the IOCs achieve through their interactions with host governments. These bargaining outcomes

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188 The concept of power as an outcome is essentially a tautological one that is most closely related with the early work of Robert Dahl. From this standpoint, power is the equivalent of successful influence, and power that is not successful is not power at all. One evaluates power by examining the outcome or result of some sequence of events or interaction. Thus, in bargaining relationship, power is indexed by the bargaining outcome or the nature of agreement, and, therefore, power can be determined only after the fact. The only way one can posit an a priori distribution of power in a bargaining relationship is to assure that the relationship reflected in the outcome of previous encounters applies to current bargaining. According to this approach, to which I subscribe, the only empirical manifestation of bargaining power lies in the bargaining outcome, and the prime value of power is that it provides retrospective interpretations for the distribution of payoff embedded in a settlement. For theoretical analysis of the relation between bargaining power and bargaining outcome, see Robert A. Dahl, “The Concept of
include the IOC’s ownership level,¹⁸⁰ the likelihood of expropriation of its operations by the host government,¹⁹⁰ and the ability of the IOC to obtain favourable concessions from the host government.¹⁹¹

Figure 2.3: IOC-Specific Resources, and Industry and Country Context as Determinants of IOCs’ Bargaining Power


In introducing industry and country-specific context, it is not an adequate approach to conceive of IOCs’ bargaining power in terms of the possession of certain resources. After all, since a host government’s intervention policy imposes severe constraints on IOCs’ strategies and operations within the host country, their relative bargaining power vis-à-vis the IOCs is the major determinant of government intervention.¹⁹² Thus, what is needed as well is an understanding of how an actor’s power is shaped by the complex web of relationships – with actors not directly party to the bargaining in which each actor is enmeshed. This myopia arises partly from the strictly dyadic character of the standard pluralist conception of power (“A has power over B”). Such an approach abstracts the actors from all other significant relationships in which they are

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¹⁹² For more detail, see Poynter, Multinational Enterprises & Government Intervention.
engaged, and thus seeks to locate bargaining power apart from these other significant relationships. In this dissertation, utilisation of the concept of ‘issue-linkage’ is helpful in tackling this problem, and this concept is explored in more detail in section 2.4.

As illustrated in Figure 2.3, IOCs’ bargaining power in a particular host state is, first of all, determined by industry and country context, by taking into account the level of competition in the country of interest; local technological and managerial know-how; capital possession; strategic importance of industry for the host country; cultural/political context; barriers to entry; reserve size and longevity; the level of economic development; potential profitability of IOC’s operations in this country; political and economic risk ratings; market access of that particular country’s NOCs; perception of world oil abundance/scarcity; and by world oil market prices. Secondly, it is determined by analysing IOCs’ resources, such as technological know-how; capital possession; management skills; reputation; reserve replacement; availability of local allies; access to markets; and by the availability of alternative investment options. In Appendix 1 I elaborate on each of these variables (19) and offer supportive scholarly evidence, which provides basis for their selection, and also briefly outline reasons for not choosing some other variables (IOCs’ home state support; host state’s international institution membership). This simple quantitative model is essential in testing the central hypothesis: If due to their weak relative bargaining power, the IOCs have been on the losing side in their bargaining with oil exporting countries and/or their NOCs in the current decade when compared to the late 1990s, then we are witnessing the return of the obsolescing bargain (Hypothesis 1).

Based on preliminary survey of the contemporary oil industry (see Chapter 1), I predict that the IOCs find themselves on the losing side of the bargain in many regions of the world, often in places where in past they have been by far the most powerful actors. Besides not being able to outbid their competitors for concessions, by applying Albert Hirschman’s framework (see above), I might suggest that the IOCs’ weaknesses are illuminated in the fact that in many bargaining situations with host states and their NOCs, they stay loyal and acquiesce to their demands, rather than raise their voice, or exit altogether. Moreover, the IOC-host state bargaining power framework (see above, and Appendix 1) is utilised to study whether IOCs’ bargaining power vis-à-vis host states (Russia, Venezuela, and Iran) and their NOCs obsolesced between 1998/99 and 2005/06, and I predict that this has been the case. If my prediction is correct, then we might be witnessing the demise of the Big Oil.

**Figure 2.4: Bargaining Outcome as a Function of IOCs’ Relative Bargaining Power (Prediction)**
2.2 Home State-MNC Relations

MNCs do not only bargain with host states but are engaged in complex relationships with their home states. MNCs play a large role in the national economies of most developed countries. As long as those countries maintain representative governments, the interests of those companies will – and, on any theory of representative government, should – carry considerable weight, and the structural power of business would most likely influence the political process even in the absence of an organised effort. This section is instrumental in understanding how academia answers the following questions, which are some of the central questions in this book: In what situations do home state’s interests resemble those of locally based IOCs so that the two can act in concert? When are their interests in opposition? Do home states usually support their IOCs in their overseas ventures, and if so, does this result in a bargaining success? These questions are central to this book.

Vested Interests

It has been suggested that while private oil companies operate independently from their national governments, they rarely act in opposition to it. Since technology is often exported from the home state to the host state, and profits are often repatriated back to the home state, Bennet suggested that the policies of the firm often conform “to the economic and foreign policies of the home government.”\textsuperscript{[193]} According to Ataman, MNCs sometimes expand the home state’s marketing base; ensure lower priced products from the foreign subsidiaries are sent back to home country; pay taxes in their home country; and their stockholders in home country gain more profit from investments made abroad.\textsuperscript{[194]}

In fact, some have suggested that not only MNCs in general, but also most IOCs have amicable relationship with their government,\textsuperscript{[195]} and that unusually close relations between companies and

their home governments have marked the history of the oil industry, particularly in the United States. Thus, according to this view, the investment decisions and interests of private IOCs tend to reflect the interests and priorities of their home governments and economies. This would imply that in some ways, MNCs, and IOCs in particular, serve national interests of home states as instruments of global economic development, a mechanism that spreads ideology and a tool of diplomacy, and in case of IOCs, they provide their home states with secure supplies of oil. While the governments seek secure and adequate supplies of oil to feed their economies, the corporations need control over reserves to ensure their future profitability in order to deliver returns to their shareholders. For governments, “secure” oil supplies often mean that these supplies are in fact part-controlled by major oil companies based in their own countries. It is argued that since in the U.S., unstable supplies and prices can upset the general functioning of the economy and strain the political system, it is thus prudent for American central decision-makers to protect American oil companies, even by the use of force. Stephen Krasner suggested, “the state should try to maximise its control over foreign sources of raw materials by promoting [and protecting] the investment activities of its own corporations.”

Moreover, American IOCs arguably receive government backing since they have significant lobbying power within their home governments (USA, UK, etc.), which are, or are becoming dependent on oil imports. For example, the U.S. oil industry has spent more than $440 million between 1998 and 2004 on politicians, political parties and lobbyists in order to protect its interests in Washington. Another source puts the figure at $231.7 million spent on lobbying between 1997 and 2000. Moreover, 4.5 million oil production royalty owners, thanks to the US private resource ownership structure, have a vested interest in supporting the oil industry and can form a very influential interest group with a broad support base, which can translate into a significant political resource, both domestically and internationally.

Thus, it is suggested that major IOCs with diplomatic support from their home governments could resist being strong-armed out of existing contracts. This was shown to be true in Jenkins’ 1986 study. Canadian NEP, helped with increased stringency of Foreign Investment Review Agency (FIRA), which monitors the entry of FDI in all sectors of Canadian economy, has widely been recognised as a surprisingly harsh and highly nationalistic policy and its implementation sparked an enormous round of protests on the part of IOCs and the US. As they were not pleased with the NEP and FIRA, American IOCs and executives turned quickly to the Reagan administration for support, which they received, as the U.S. government was ideologically opposed to the interventionist nature of the NEP. U.S. government’s support helped American IOCs not to be on the losing side of the bargain in Canada. In what is supportive of Jenkins’ study, Mary-Ann Tétreault has shown that when in 1987/88 KIO, a part of the Kuwait

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196 Noreng, Crude Power, p. 44.
198 Krasner, Defending the National Interest, p. 39.
201 In addition, other interested parties include the royalty owners’ dependents, individuals benefiting from industry trickle-down effects, industry employees and individual/institutional oil company shareholders. Ian Rutledge, “Profitability and Supply Price in the US Domestic Oil Industry: Implications for the Political Economy of Oil in the Twenty-first Century,” Cambridge Journal of Economics, vol. 27, no. 1, 2003, pp. 1-23.
Investment Authority, bought a 23 percent stake in BP, BP’s board members appealed to the British government to intervene, arguing that what was ostensibly a portfolio transaction by KIO was in fact a veiled attempt by KPC to take over BP. BP’s appeal to the British government to intervene was successful. Moreover, by studying U.S. government-oil industry collaboration in pursuing their interests in the development of Caspian region’s energy resources in the 1990s, Ran Goel suggested that there exists an implicit executive-industry bargain, in which the executive (the U.S. President) furnishes the political, military and, to a lesser extent, economic elements necessary for the industry’s international oil exploration, production and transportation functions. In turn, the oil industry acts as a foreign policy stalwart due to its technology, capital and longstanding submission to foreign policy objectives. What one could assume from Goel’s argument is that the U.S. President, and the U.S. Congress, which is heavily supportive of the oil industry due to the industry’s lobbying power, share similar if not the same interests and are closely aligned with the oil industry.

**Conflicting Interests**

However, despite Jenkins’, Tétreault’s, and Goel’s findings, Joe Barnes suggested, “history provides countless examples of Washington sacrificing the interests of U.S. oil companies to broader goals.” The IOCs are very large and politically powerful private actors, whose primary objective is profit maximisation. This objective often differs from primary objectives of the IOCs’ home states. Generally, when we observe activities of MNCs, we see that their operations create a variety of problems for home countries, or states in which a foreign MNC has its headquarters. Conflict between MNCs and their home states often arises over various issues, such as taxation, trade policies, security issues, and economic sanctions, where MNCs often disagree with and/or do not want to follow policies pursued by their home governments. Moreover, Western governments do not necessarily benefit from the foreign activities of their MNCs, and this is primarily due to differing interests between the government and the MNC. Lack of national identity within MNCs plays a role too, since MNCs in general appear to be losing their national identities and loyalties as they increasingly view markets from a global and not local perspective. Vernon has shown that even in the early 1970s, although U.S.-based MNCs were 90 percent or more American by equity ownership, they were just 25 percent American by sources of funds, less than 1 percent American by the identity of employees, and practically 100 percent foreign by the identity of the governments that receive their taxes. Thus, foreign sources of funds, foreign employees, taxes paid in foreign countries, and the very fact that these companies function in many different countries result in differing interests to those of their home governments. In fact, Vernon suggested that the liaison between the British, Japanese, French, German or Italian government and their enterprises regarding their interests 204 Tétreault, *The Kuwait Petroleum Corporation*, pp. 200-2.
206 Joe Barnes, “NOCs and U.S. Foreign Policy,” paper prepared in conjunction with an energy study sponsored by Japan Petroleum Energy Center and the James A. Baker III Institute for Public Policy, Rice University, March 2007, p. 10.
207 Krasner, *Defending the National Interest*, p. 7.
210 Ibid. Raymond Vernon studies conflicts between MNCs and their home governments in *Storm over the Multinationals*. See particularly Chapter 6, pp. 103-138.
211 See Vernon, *In the Hurricane’s Eye*, p. 264.
outside their respective home countries appear much more intimate and continuous than is the case for the United States.213 Some European nations have developed reputations of being strong supporters of their MNCs (and IOCs in particular) who, in turn, have strong voices in their own government.214

When considering such background, some have suggested that although it depends on private companies to develop reserves and supply the nation with oil at a profit, the U.S. government does little to support its private oil companies both home and abroad, and the only edge the U.S. IOCs have over NOCs is their superior technology.215 Historical examples of problems arising between American IOCs and the U.S. government are plentiful. For example, according to Stephen Krasner, in the early 1970s, U.S. oil companies wanted support from the state against the pressure that was being placed on them by Saudi Arabia and Iran. However, American IOCs received no serious support from the U.S. government. Without state support, the oil companies could not resist pressures from even weak states and thus they failed to prevent price increases and nationalisation. Thus, by the mid-1970s the oil industry had to move to accommodate itself to OPEC.216 U.S. policy-makers were in this instance more concerned with keeping a lid on the political situation, and maintaining the authority of conservative governments, such as that of Shah in Iran and the Saudi monarch, than they were with the prerogatives of the oil companies, which were frequently ignored.217 Similar development, as shown by Krasner, occurred when American central decision-makers turned a deaf ear to oil company entreaties for more vigorous official backing in Peru and Mexico before World War 2.218

Moreover, American IOCs were the primary losers after voluntary and later mandatory oil import quotas were established in the U.S. in the 1950s, as they could import very limited quantities of internationally produced oil.219 Further, historically, it was against American IOCs’ interests to go to Iran after Mossadeq was overthrown in 1953. However, they agreed to do so, but only after the anti-trust suit against them was downgraded by an order from President Truman from a criminal to a civil action, and after heavy pressure from the U.S. government on national security concerns over Iran potentially falling to the Communist bloc if the oil production failed to be resumed.220 In an unrelated incident, the United States was impotent in using Gulf Oil, an American oil company, in the 1976 civil war in Angola, as after the briefest hesitation, Gulf Oil turned over several hundred million dollars to the winning side, even though the U.S. government had backed that side’s enemies and had not yet recognised the victor.221

213 Ibid, pp. 218, 229 and 235.
216 Krasner, Defending the National Interest, p. 254. The U.S. government did not want to resist nationalisations in many developing countries in the 1970s due to its fear that in such scenario they may have tilted towards the Soviet Union. See Barnes, “NOCs and U.S. Foreign Policy,” p. 20.
217 Krasner, Defending the National Interest, pp. 256, 259-60 and 262.
218 Ibid, p. 332; and Barnes, “NOCs and U.S. Foreign Policy,” p. 20. When U.S. oil companies’ interests were nationalised by Mexico in 1937, while the nationalisation roiled relations between Mexico City and Washington, it never led to a break. The reason is clear: increasingly worried about the Nazi menace in Europe, the Roosevelt Administration wanted at all cost to avoid a restive neighbour to the South or, worse, one aligned with Hitler’s Germany.
220 For more on this fascinating topic see Yergin, The Prize, pp. 471-2; and Krasner, Defending the National Interest, pp. 119-128.
In another example, American IOCs involved in a number of Middle Eastern states, clearly did not support the U.S. tilt towards Israel during the 1973 Yom Kippur War. In yet another example, Vernon argued that the 1970s oil crisis provided evidence that governmental use of IOCs as arms of public power had its limits. In the oil crisis, these limits were swiftly reached, as none of the developed countries succeeded in obtaining greatly preferred treatment from the IOCs they thought of as their own, although a number of governments tried. Some have even suggested that during the oil crisis of the 1970s, the U.S. government threatened to nationalise Exxon, along with other IOCs, based on a belief that they caused a severe increase in oil prices. Thus, Vernon argued that the realisation that IOCs cannot be used simply as an extended arm of government was a lesson half-learned by the governments involved in the oil crisis of the 1970s. Home governments should have learnt this lesson in the 1940s, when oil companies successfully used their advantage in the Congress to block government’s efforts to use them to further security of Middle East oil supplies during the World War 2.

Vernon suggested that in future, MNCs could face obsolescing bargains in their home countries, as many of these states are demanding more from the MNCs, by asking, “What have you done for me lately?” For example, one issue for conflict could be that MNCs might prefer more open markets than would many of their home states, particularly the European ones. Another issue of contention could be over the fact that major American IOCs vehemently oppose official U.S. policy on Iran, Sudan, or Libya and Iraq (until recently), which prohibits them from investing in these oil rich countries. The bottom line, according to Vernon, is that “whenever national governments use multinational enterprises as an executive arm carrying out national policies, they must recognise that the enterprises on which they rely have interests that extend beyond the borders of any single country.” Therefore, on one hand, the interests of the IOCs and their home governments may converge regarding some issues, as for example during the early 1920s, when central U.S. decision-makers actively backed American oil companies in Central America, Colombia, Venezuela, Albania, and, most vigorously, the Middle East and the Dutch East Indies (today’s Indonesia). Moreover, in the 1990s, aligned government-corporate interests resulted in the U.S. government’s support for its IOCs in the Caspian, and this in turn ensured American IOCs’ success. However, on the other hand, their interests may diverge in relation to other issues (Middle East, Peru and Mexico in the 1940s, Iran, Indonesia and Liberia in the early 1950s; Angola in 1976; Israel in the 1970s; the oil crises and nationalisations of the 1970s; etc.).

If home governments wish to change the IOC behaviour in some of the situations in which their interests do not converge, they must understand that they do not have instruments of control that would allow them to force a change in private behaviour. In such situations, according to David Vogel, public opinion may help them influence private behaviour, as although oil interests may have successfully defended their agenda during a given period, continued success is not a

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222 Barnes, “NOCs and U.S. Foreign Policy,” pp. 10 and 21. It is unquestionable that U.S. support for Israel, and the price for which the U.S. paid for it in the Arab and, indeed, Muslim world, has not been based upon narrow U.S. energy interests.
226 See Krasner, Defending the National Interest, p. 213.
227 See Vernon, In the Hurricane’s Eye.
228 Ibid.
229 Barnes, “NOCs and U.S. Foreign Policy,” p. 10.
230 Vernon, Storm over the Multinationals, p. 135.
231 Krasner, Defending the National Interest, p. 107 and Vernon, Sovereignty at Bay, p. 209.
232 Krasner, Defending the National Interest, p. 98.
deterministic affair. For example, major shifts in public opinion – be they in response to Standard Oil’s monopolistic practices or the Exxon Valdez oil spill – have eroded the influence of such entrenched interests. At other times, only skilful bargaining can help home governments influence private behaviour.

Raymond Vernon suggested that U.S. government’s involvement in American IOCs’ bargaining with foreign governments is ineffective and undesirable, without considering whether their interests converge in these situations. According to Vernon, although there are times when governmental help is wanted, or even demanded, as in the case of early 1980s oil industry bargaining in Canada, managers of large MNCs “have been aware that trying to pit government against government in an effort to solve their problems could have a price in terms of ill will and retaliation.” Vernon suggests, “Even when pressure on behalf of a multinational enterprise has been applied by so powerful an advocate as the U.S. government, one could not be sure if it would work.” Moreover, “when U.S.-controlled enterprises have felt foreign governments breathing down their necks, the disposition has been to find some formula to relieve the pressure locally without inviting the U.S. government into the fray.” Finally, according to Vernon, “strategies that involve intergovernmental threat or collaboration have taken a very low place in the list of possible responses.” Vernon’s suggestions and numerous historical episodes in which the U.S. government’s and American IOCs foreign policy interests and actions were not in concert imply that situations in which U.S. government improved bargaining power of American IOCs are exceptions to the rule. In summarising the IOCs’ position between their home and host governments, the view held by Louis Turner, who does not see IOCs as automatic allies of consumer governments, or pure agents of producers, is worth considering. In turn, he perceives them as “actors with economic interests at both ends of the oil operation, and hence vulnerable to the displeasure of either set of governments” and “they are thus having to learn how to reconcile such conflicting pressures.”

Summary

While various studies surveyed above suggest that the U.S. government’s and American IOCs’ interests often diverge, and some even suggest that home states support is ineffective and unwanted by the IOCs (see section on home state-MNC bargaining), these studies mainly offer somewhat dated empirical evidence. In recent years, many have suggested that there exists a close relationship between the Bush Administration and the oil companies, by reminding us that many high profile politicians in this administration, in past worked for, and are still closely related to the energy industry. Therefore, conspiracy theories that the Bush Administration has been closely aligned and acting in concert with the IOCs, are commonly heard. Some have even gone so far as to suggest that the major American IOCs hijacked the current administration, and have been using it to further their interests. Thus, I will base my prediction on these popular

234 Vernon, *Sovereignty at Bay*, p. 262.
235 Ibid.
237 The first and second Bush administrations have had many oil and energy industry connections: President Bush is a former director of Harken Energy Corporation; Vice President Cheney is the CEO of Halliburton; and Secretary of State Condoleeza Rice is a board member of Chevron, one supertanker of which was named after her. Moreover, financial disclosure forms reviewed by the Center for Public Integrity, a non-partisan watchdog group, reported that top 100 officials in the first Bush Administration have the majority of their personal investments, almost $150 million, in the traditional energy and natural resource sectors. Michael Moran and Alex Johnson, “Oil After Saddam: All Bets Are In,” MSNBC News, November 7, 2002, http://www.msnbc.com/news/823985.asp?cid=.115114700, [October 7, 2003].
238 Bill Minutaglio, the Bush bibliographer, said, “Bush really does believe that what is best for Big Oil is best for America. His whole formative world view was formed by being hip-deep in the oil patch.” Cited in Michael R.
beliefs, which nevertheless have some theoretical grounding in studies previously conducted by Jenkins, Tétreault, and Goel. In order to find out whether the American IOCs’ and the U.S. government’s interests are aligned; if so, whether the IOCs receive necessary support; and if they do, whether this support results in their bargaining success, I will study bargaining for UNOCAL, a mid-sized American independent oil company, bargaining for drilling rights in the Arctic National Wildlife Refuge (ANWR), and oil industry bargaining in Russia, Venezuela and Iran, countries of much interest for American IOCs. Although the above survey of home state-MNC literature shows conflicting evidence, I hypothesise that if the interests of American IOCs and the U.S. Government are aligned, then the U.S. Government supports American IOCs in bargaining with other actors, and related, if American IOCs receive support from the U.S. Government from time to time, then this support results in bargaining success against other actors (Hypothesis 2).

Figure 2.5: U.S. Government’s Support for American IOCs as a Function of Their Interests (Prediction)

![Diagram of U.S. Government’s Support for American IOCs]

Figure 2.6: American IOCs’ Bargaining Success as a Function of the U.S. Government Support (Prediction)

![Diagram of American IOCs’ Bargaining Success]


2.3 The Rise of China and the New Age of Energy Security

The U.S. and other Western IOCs may be on the losing side of their bargains with oil exporting states and their NOCs (see Hypothesis 1), and they may be struggling to attract their home state support (see Hypothesis 2). However, they also may be losing out to China’s NOCs, who have been very aggressive in their pursuit of overseas oil interests. In the larger trend of more powerful NOCs globally, China’s NOCs are an ideal case in the study of bargaining because of assertiveness, aggression, and unconditional government support in their pursuit of oil. The rapid growth in China’s oil imports, fastest in the world, is largely behind such characteristics. Energy consumption is proportionally linked to economic growth. In other words, for economic activity to increase there has to be a proportional increase in energy consumption. Currently, Chinese NOCs are spending billions of dollars on a global scramble for oil and gas to secure sufficient energy needed to feed China’s economic growth. Chinese NOCs have access to modern technologies, and they have been bidding for concessions overseas. In overseas bidding, since they are directly supported by the Chinese government, they do not play by the same rules as private oil companies. In what has been identified as “China’s global hunt for oil,” under China’s broader “going out” (zhou chu qu) policy, three major Chinese NOCs (the

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242 Ibid, pp. 10-1.


244 This policy, based on November 2001, the State Economic and Trade Commission’s (SETC) energy strategy, encouraged China’s three NOCs to build up secure supplies abroad through purchasing equity shares in overseas markets, exploring and drilling abroad, constructing refineries, and building pipelines. Leverett and Bader,
China National Petrochemical Corporation/Sinopec, the China National Petroleum Corporation/CNPC/PetroChina and the China National Offshore Oil Corporation/CNOOC) “have been working overtime to make themselves players in world oil, willing to pay top dollar to get into the game.” In the course of less than a decade, they have become significant new players on the global industry scene, with increasing investment stakes in the Middle East, Russia, Central Asia, Africa, Latin America and Canada. Although these NOCs might not be gaining bargaining power vis-à-vis NOCs from the oil exporting countries, they are certainly competing with the IOCs. Thus, China’s and other oil-importing countries’ NOCs allow oil-exporting countries and their NOCs to have a wider range of potential investors. Studying oil industry bargaining in Venezuela and Iran, and Russia to a lesser extent, and bargaining for UNOCAL, will help determine whether China’s NOCs are prevailing at the IOCs’ expense in bargaining with oil exporters and their NOCs. Thus, I hypothesise that if the NOCs from China are gaining bargaining power, then this is at the expense of the IOCs (Hypothesis 3).

Figure 2.7: IOCs’ Bargaining Power Relative to Bargaining Power of China’s NOCs (Prediction)
As discussed in Chapter 1 (in the section on oil importers), due to a wide variety of reasons, energy security is at the top of the agenda for governments of many oil-importing countries, and in particular for the United States, Japan and China, the world’s three largest crude oil consumers and importers. It is evident from the previous paragraph that China certainly devotes enormous resources in order to secure sufficient oil supplies reach its shores, which is something that other oil importing governments may find threatening. An interesting question logically arises from this renewed interest in energy security: when oil supply security is perceived as threatened when these governments bargain with other actors, do they succeed in that particular bargaining case? In the 1970s, despite sit’s strong need for oil, Japan has not been successful in bargaining with other actors in the face of the Arab oil embargo. When they perceive a threat to their oil supply security, it is reasonable to expect that major oil-importing governments would invest considerable resources in order to achieve a positive bargaining outcome. However, based on Japan’s past failure, it is expected that in such cases, they do not achieve a favourable bargaining outcome, and thus I hypothesise that if a major oil-importing government’s oil supply security is perceived as threatened when bargaining with other actors, then this government will not emerge victorious from bargaining (Hypothesis 4). This hypothesis will be tested by analysing bargaining for ANWR, bargaining for UNOCAL, oil industry bargaining in Iran and Venezuela, and pipeline bargaining in the Russian Far East.

**Figure 2.8: Oil-importing Government’s Bargaining Success as a Function of Oil Supply Security Threat Perception (Prediction)**
2.4 Issue Linkage

A study of bargaining necessarily raises questions about definition of an issue-area and linkages among issues, since bargaining is contextual, and to exercise influence on one issue often means making concessions on another. Understanding the concept of issue linkage is instrumental in order to be able to assess whether oil exporters, besides the fact that they may be successful in bargaining vis-à-vis the IOCs (see Hypothesis 1), by using oil as a bargaining chip, are also able to gain concessions and achieve their goals in other bargaining arenas.

Keohane and Nye define a set of issues as an ‘issue area’ when those who are working to resolve that set of issues view the issues as closely interdependent and deal with them collectively. The politics of the law of the sea differ from the politics of nuclear proliferation, the politics of tariffs from the politics of oil. Hence, scholars must distinguish carefully the actors and issues involved in any set of interactions under study. In choosing to examine bargaining in the oil industry, I treat the interactions of all actors involved as an issue area—a set of issues influenced by, and nested within, other issues, but sufficiently related that they form a package. A person, a group of people, an institution representing a group of people, or a corporation can be an actor in a given issue area only if it possesses a distinct set of preferences and sufficient capabilities for participating. The main actors involved in bargaining in the oil industry were introduced in Chapter 1.


Bargaining typically encompasses several, complex issues. Two diametrically opposite techniques to handle this complexity are identified in the literature. One is issue disaggregation, also referred to as issue decomposition and sequencing. This incremental approach, which involves negotiating each issue separately and sequentially, rests on the belief that half a loaf is better than none. It often entails organising working groups to deal with specific issues or sub-issues. Issue aggregation or issue linkage represents another method of handling complexity. Issue linkage entails combining sub-issues that would be non-negotiable if treated separately into package deals and tradeoffs, and it allows for an endless variety of contextual factors influence bargaining behaviour and processes. The oil industry is as an issue area not in isolation from the rest of society. My analyses recognise that the issue area of oil is intimately connected to broader political and international issues. The concept of “nesting”, originally developed by Vinod Aggarwal’s international systems theory, will be used in the case study chapters (3 to 6) as an issue-linkage tool. “Nesting” will enable me to link bargaining in the oil industry with other bargaining arenas. In other words, “nesting” can help us contextualise a given bargaining case within a whole network of bargains, and not look at it in isolation.

In explaining the creation of regimes from the perspective of a hierarchy of systems, Aggarwal uses nesting, a systemic level factor. For Aggarwal, the textile system is nested within the overall trading system, and the trading system is nested within the overall international strategic system (concerning security matters), and actions countries take in other systems influence behaviour in the textile subsystem. Similar to textile bargaining, it is important to note that bargaining in the oil industry is not isolated from the rest of international and domestic bargaining. Bargaining between actors in the oil industry is influenced by, and linked to, the actors’ interests and behaviour outside the oil industry. States tend to have many interests outside a particular market; firms, few. Since states, their leaders and domestic constituencies have a complex set of interests, non-oil interests can affect their behaviour in the oil industry bargaining. In other words, the developments in oil bargaining arena can be a result of not only an individual actor’s non-oil interests and behaviour but also the actor’s position in a more general international political and economic structure. Similarly, developments in oil bargaining arena can influence bargaining in other arenas.

Empirically, oil has the power not only to catapult a country into international politics, but also to entice an oil-rich country to pursue more power. Various scholars suggest that oil exporters use oil to get concessions from other actors, and two major historical examples support this view – the Arab oil embargo of 1973, and the U.S. embargo on Imperial Japan’s oil imports in

251 Aggarwal, *Liberal Protectionism*, p. 27.
252 Ibid.
However, on both occasions, oil-exporting states did not manage to gain concessions from other actors, as the Arab oil embargo did not stop the U.S. in its support for Israel, and the U.S. embargo against Japan, resulted in Japan continuing, not halting its military quest in Asia. This proposition will be tested in the case of Iran and its pursuit of nuclear technology, Russian oil industry bargaining, Russia’s Far Eastern oil pipeline bargaining with China and Japan, and Venezuela’s attempt to spread “Bolivarian Revolution.” I hypothesise that if oil-exporting states use oil, explicitly or tacitly, in their bargaining with other actors, they do not gain concessions in other bargaining arenas (Hypothesis 5).

Figure 2.9: Concessions as a Function of Oil-exporting States’ Use of Oil as a Bargaining Tool (Prediction)

Conclusion

The first two chapters provide the empirical and theoretical framework for the rest of this book. In Chapter 1, I briefly outlined the importance of oil and characterised the international oil market as a politicised market. I also illustrated why studying bargaining relationships among various oil industry actors is the most effective way for studying oil. Following, I introduced the major actors in the oil industry and outlined the characteristics of the present, conflictual, stage in the oil industry. Finally, based on these characteristics and issues, I established various research questions which are the focus of this book. In Chapter 2, in light of various research questions outlined in Chapter 1, I analysed various previously established theoretical debates and frameworks in order to highlight the way in which academia understands these issues and which are helpful in analysing them. This analysis doubled up as the basis for outlining the hypotheses and thus the main research questions.

Note that the U.S. was a major oil exporter in 1941. Moreover, the U.S. continued using the “oil weapon” even as an importer. It used sanctions (The Iran-Libya Sanctions Act - ILSA), aimed at reducing revenue by denying investment to hostile regimes, as instruments of foreign policy against oil-exporting countries. For more on ILSA, see Chapter 6.
It is important to bear in mind that none of the hypotheses established above will be tested in each particular case study chapter (3 to 6), and each case study does not necessarily test only one hypothesis. For the sake of brevity, the hypotheses are revisited in Chapter 7 rather than at the end of each case study. However, towards the end of each case study chapter, I elaborate on the relationship of that chapter with the hypotheses. When testing the hypotheses in Chapter 7, in most cases I employ qualitative methods, whereby I simply analyse the findings and discuss whether the hypothesis was supported. However, in testing the Hypothesis 1, which is based on the oil exporting state-IOC bargaining power framework, I use a simple quantitative method for the sake of clarity. The large number of variables (19) simply made it too difficult to engage in straightforward and comprehensive qualitative analysis (in Appendix 1 all of the variables are introduced and their selection justified).
PART 2: CASE STUDIES

In Part 1 of this dissertation, I established the empirical and theoretical framework, which provides the reader with the appropriate foundation for the rest of the book. I now turn to contemporary oil industry bargaining case studies, six of which will be analysed in the following four chapters. However, before I engage in my case studies, it is essential to outline the reasons behind case study selection, and sketch the methodology for studying these cases.

Case Selection and Methodology

The four states chosen as case studies in chapters 3 to 6 (Russia, Venezuela, the United States, and Iran) are the most crucial and most different cases that carry the most significance in testing the hypotheses. All four countries are in possession of large oil reserves and are major oil states, of which three are net exporters (Russia, Iran, and Venezuela) and one is the largest net importer and consumer of oil (the U.S.). In 2005, Iran (2nd largest oil reserves in the world), Venezuela (6th), Russia (7th) and the United States (11th) were cumulatively in possession of 320.9 billion barrels, or 26.7 percent of world’s total proven oil reserves (see Table 1.1). Russia (2nd largest oil producer in the world), the United States (3rd), Iran (4th), and Venezuela (8th), were all among world’s top 10 oil producers, in total supplying 23.4 million bpd, or 28.9 percent of the world’s total (see Table 1.1). Further, Russia (2nd largest oil exporter in the world), Venezuela (4th), and Iran (5th) exported 11.6 million bpd, or 23.3 percent of world’s total traded oil. In 2005, the United States was by far the largest oil consumer in the world, with demand higher than that of China, Japan, Germany, Russia and India combined. It is therefore crucial to study oil industry bargaining in both net oil exporting and importing countries.

Of the three oil exporters, two (Iran, Venezuela) are OPEC members, and Russia is not. Iran is the second largest OPEC crude oil producer and net exporter, behind Saudi Arabia, while Venezuela is the third largest OPEC, and the largest non-Middle Eastern OPEC, crude oil producer and net exporter. This will provide us with insights from both Middle Eastern and non-Middle Eastern OPEC oil producers and exporters. In addition, Russia is by far the largest non-OPEC oil producer and net exporter, and thus, studying oil industry bargaining in Russia is very important. On the consuming and importing side, the United States is overwhelmingly the world’s largest oil consumer, with demand higher than that of China, Japan, Germany, Russia and India combined. It is therefore crucial to study oil industry bargaining in the U.S.

Of four countries chosen, the United States is a developed, Western country, and a democracy, with high standards of living, and de jure privatised oil industry. Russia is a transition economy and a former communist country, with medium standards of living, partly democratic, and with hybrid private-state controlled oil industry. Finally, Venezuela and Iran are developing countries, of which Iran is an authoritarian Islamic Republic, and Venezuela is an increasingly authoritarian republic. Both have low to medium standards of living, and in both countries oil industry is under full state control. Given the limited theoretical work that exists on oil, I decided to take an expansive approach designed to draw theoretical observations based on examination of a large range of empirical cases. This will ensure that my theoretical findings are generalisable and falsifiable as sound theories should be.

Six oil industry bargaining cases in four countries offer us most oil bargaining scenarios one could think of – those between governments (Russian oil pipeline bargaining, Iranian oil industry bargaining), between government and foreign IOCs (Venezuelan oil industry bargaining), and between government and domestic constituencies (Russian oil industry bargaining, bargaining for ANWR, and UNOCAL to an extent). Possible bargaining situations, which are not included, are those between governments and international organisations (OPEC or IEA), and between intergovernmental organisations (OPEC and non-OPEC and/or IEA). Studying a particular bargaining case, for example, within OPEC, or between OPEC and the IEA would involve too many actors and could not be covered in sufficient detail in this dissertation. Additionally, bargaining over production quotas and over the actual production between various OPEC producers and between OPEC and non-OPEC producers has not been studied because of the lack of spare production capacity in the contemporary oil markets. Since the basis for bargaining over oil prices within OPEC is the relationship between withholding capacity and idle capacity, thus, if this study surveyed oil bargaining in the 1970s or 1980s, when most OPEC and non-OPEC oil producing countries possessed considerable spare production capacity, such a case study would have been essential.

A question could be asked on why I did not choose to study oil bargaining in other countries, which are also very important in the IPE of oil. For example, on one hand, in 2005, Saudi Arabia was the country with largest crude oil reserves in the world, and the world’s largest oil producer and net exporter, which one could argue are important reasons for being chosen as one of the case studies. On the other hand, Japan, China, and a number of E.U. countries (Germany, France, and Italy) were all important crude oil consumers and net importers, which could have been chosen as cases in studying oil industry bargaining. There are several important reasons why I did not choose these countries. Firstly, in deciding which Middle Eastern OPEC producer to study, I did not choose Saudi Arabia firstly due to its uniquely huge reserves, which give it much greater advantage in politics, and which do not make it representative of a typical oil exporting country. Secondly, Saudi Arabia is not studied because Iran is the most interesting case. As this study is concentrated on contemporary oil industry bargaining, I was puzzled by the magnitude of oil investment in Iran despite the unilateral U.S. sanctions, which oppose oil investment in Iran. Further, I thought that studying Iranian oil industry bargaining as “nested” within Iranian nuclear program would make an exciting case study. Nothing of this sort is occurring in Saudi Arabia. On the oil consumer/importer side of the bargain, while I do not dedicate special chapters to oil industry bargaining in China, Japan, or the E.U. countries, it is important to note that these countries feature prominently in most of the case studies. China features in oil industry bargaining in all four chapters – it is involved in Russian Far Eastern oil pipeline bargaining, in Venezuelan oil industry bargaining, in bargaining for UNOCAL, and in oil industry bargaining in Iran. Japan features in Russian Far Eastern oil pipeline bargaining and in oil industry bargaining in Iran, whereas the E.U. countries feature in oil industry bargaining in Iran.

I adopt the same method in studying oil industry bargaining in all four case study chapters. Firstly, I briefly look at history of oil industry bargaining in each particular country. This offers us some important insights into oil industry bargaining, illustrates historical tendencies and forces within those countries, and where have these tendencies led us. I use the history of oil industry bargaining to examine how contemporary oil bargaining came to be shaped, as history is necessary to provide a background context to the discussion of current issues. It is important to

keep in mind that it is not intended to be a comprehensive history of oil industry bargaining in each country. Secondly, I briefly introduce each country’s oil industry and crucial oil statistics. Thirdly, and most importantly, I examine bargaining between the major actors in each particular contemporary oil industry case study. In Chapter 3, I study two bargaining cases in Russia – domestic oil industry bargaining and Russian oil pipeline bargaining, particularly concentrating on Putin’s crackdown on Russian oligarchs and on Far Eastern pipeline bargaining between Russia, China and Japan. In Chapter 4, I study oil industry bargaining in Venezuela by concentrating on recent changes in Venezuela’s laws under Chavez’s rule, and influences this brought upon foreign oil industry actors. In Chapter 5, I look at two different instances of oil industry bargaining in the United States – bargaining for UNOCAL, involving Chevron, an American IOC, and CNOOC, a Chinese NOC, as the main actors, and bargaining for the Arctic National Wildlife Refuge (ANWR) featuring two diametrically opposed coalitions as the main actors. In Chapter 6, I study contemporary oil industry bargaining in Iran, considering it nested within Iranian nuclear bargaining. Finally, I conclude each bargaining case with analysis of the relationship of each case study with the hypotheses. Goals of each actor involved in any particular oil bargaining case are presented in a table at the beginning of each case, and detailed timelines for all bargaining scenarios are presented as appendices (see Appendices 2-7).

It is worth noting that since all of the oil industry bargaining cases studied in this dissertation are contemporary, many are still ongoing at the time of conclusion of research. Thus, in some cases, there is no formal agreement between the parties. However, communication has taken place in each of the case studies, even in the absence of direct negotiations, and this is an indication that bargaining has taken place, albeit tacitly. All actors in all case studies have common and conflicting interests, which is a prerequisite for a bargaining situation. Finally, actors have changed their positions in the course of the period with which I am dealing, what is another precondition for my case studies to be considered as bargaining situations.

My case studies are not parsimonious, as such approaches, according to James Rosenau, “are compelled to ignore the multiple macro and micro levels at which sources of turbulence stir and gather momentum.” Therefore, this dissertation forsakes parsimony in order to “acknowledge multiple layers of causation,” and to engage in comprehensive analysis of bargaining in the oil industry. The complexity of my approach can lead to incoherence. However, the aspects of oil industry bargaining examined here are not empirically arbitrary. As will become evident in Chapter 7, the cases discussed are interrelated and not isolated.

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259 Ibid.
RUSSIA

The focus of this chapter is on contemporary oil industry bargaining in Russia, and this is achieved by engaging in two case studies – one studying domestic oil industry bargaining in Russia, and the other examining Russian Far Eastern pipeline bargaining, involving Russia, China, and Japan. In both case studies, the bargaining outcome is primarily determined by political and not economic factors. If it was not for politics, Russia’s oil sector would be increasingly privatised and not gradually nationalised; Yukos would be building the pipeline to Daqing; and Khodorkovsky would not be in prison. Putin’s power consolidation vis-à-vis the oligarchs is a major political factor which influenced the outcome of domestic oil industry bargaining. Moreover, the Kremlin has been deeply reluctant to give up the political influence that controlling Russia’s geopolitically important export flows affords. Thus, the rise of resource nationalism in Russia is clearly a political factor.

Economics played a secondary role in influencing the outcome of oil industry bargaining in Russia. The FDI in the oil sector, which would help Russia’s long-term economic growth, is now discouraged. The critical issue in final decision over pipeline routes is not the relative economic merits of alternative pipelines, but the decision-making process. The cheaper pipeline option, to China, may be chosen primarily because of political reasons, and not because of the price of construction. High market prices of oil have very little influence on the outcome of bargaining. Since Russia’s economy is not as reliant on income from oil exports as that of some other economies, the change in oil price does not have much effect on it. Moreover, Putin’s sound macroeconomic management, which has seen much of the oil windfall saved in the oil fund, will insulate Russian economy from a falling oil price.

Footnotes:
260 “Russia will have to worry about how it gets foreign investment inside to make sure that its incomes from exploitation of hydrocarbon resources are held steady over time.” Edward Morse quoted in “U.S.-Russia Energy Summit Executive Seminar,” p. 7.
261 Ahrend and Tompson, “Realising the Oil Supply Potential of the CIS,” p. 43.
262 “Gas, more than oil, is Russia’s largest source of export earnings.” Lo, Vladimir Putin and the Evolution of Russian Foreign Policy, p. 63. I am referring mainly to the economies of the Middle Eastern, African, and Latin American oil exporting countries. It is too early to know whether Russia will suffer from the “resource curse” or the “Dutch Disease.” Russia is endowed with many human and cultural advantages not enjoyed by other resource-rich countries and, therefore, has better policy choices. Edward C. Chow (“U.S.-Russia Energy Dialogue: Policy, Projects, or Photo Op?” Foreign Service Journal, December 2003, p. 39) argues that President Putin’s policy choices aim at developing other industries in order to prevent the “Dutch Disease” away from Russia’s economy. Also, see William Tompson, “A Frozen Venezuela? The ‘Resource Curse’ and Russian Politics,” in Michael Ellman (ed.), Russia’s Oil and Natural Gas: Bonanza or Carrot (London, Anthem, 2006). Russia has more than doubled the size of its stabilisation since its inception in early 2004, which stood at about $43 billion as of end-2005. In addition, its foreign reserves grew from $44.7 billion in 2002 to $162.3 billion in 2005, which is indicative of high rate of saving. McCown, Plantier and Weeks, “Petrodollars and Global Imbalances,” p. 4.
263 Russia would suffer recession only if oil prices fall below $10 a barrel – highly unlikely in the long-run. See “U.S.-Russia Energy Summit Executive Seminar,” p. 2.
ready to play by the Kremlin’s rules. Due to resource nationalism, in the near future, the IOCs are not likely to make large investments in Russian oil sector. Any international pressure by their home governments against Russia would do them more harm, and would further compromise their bargaining position, which is weakened after their defeat in Russia.

Introduction to Russia’s Oil Industry

Historically, Russian oil industry has undergone cyclical phases of state and private control. The periods between 1829 and 1873, and 1930 and 1990 witnessed the state control of the industry, while the period between 1873 and 1921 was when the industry was in hand of foreign and private control, and when Russia saw “the rapid, large-scale industrialisation… of the oil industry in particular, fuelled by a vast infusion of foreign capital.” Periods between 1921 and 1930 and the late 1980s and 1990s were transitions, where foreign participation and private ownership were invited but the state was still involved. Between 1929 and 1990, during the Communist rule there were twelve five-year plans, with no private or foreign participation. Gorbachev’s reforms to decentralise the economy beginning in 1987 did not have a salubrious effect on the oil industry as oil remained under centralised control. High costs, controlled prices, high gross profits taxes, and limited investment funds from the central government limited their profitability and ability to maintain production. Thus, production fell in 1989 and 1990.

Since 1985, first under Mikhail Gorbachev and then under Boris Yeltsin, the recourse to foreign investment has seen one of the best means of financing a sector with considerable investment needs. Russia’s aim of integrating itself into the world market contributed to significant IOC involvement in the country. Although joint ventures with western companies had been encouraged, the complexity of required procedures and high risk had discouraged all but two companies from investing in the Russian energy sector by 1989.

Meanwhile, shortages and unrest plagued the economy. By the end of 1990, all 15 Soviet Republics had become politically independent or had gained legal sovereignty. Russian crude oil production continued to decline. The former oil ministry became Rosneft and the daunting task of converting from a planned to a market economy began, and the West helped with pious advice. In the early 1990s, there were notable difficulties in the transition from a centralised command to a competitive market economy. However, we could witness some early foreign investment in the form of working over and refurbishment of idle wells, JVs, and PSAs.

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265 Torbakov, “Yukos Bankruptcy.”
267 Considine, The Russian Oil Economy.
268 Title to all oil produced remains with the Russian side; the Western oil company, which receives no equity stake, is paid with the proceeds of the enhanced oil production, which is exported for dollars. Having identified the repair of idle wells as the industry’s top short-term priority, the Russian government has actively encouraged this type of investment. In January 1992, presidential decrees exempted such projects from the loathed export tax, and provided special export quotas so that oil produced could be sold abroad. James Watson, “Foreign Investment in Russia: The Case of the Oil Industry,” Europe-Asia Studies, vol. 48, no. 3 (May 1996), p. 432.
269 Most of the first deals negotiated in Russia were of this type. For more details see ibid. p. 433; and Andreas Heinrich, Julia Kusznir and Heiko Pleines, “Foreign Investment and National Interests in the Russia Oil and Gas Industry,” Post-Communist Economies, vol. 14, no. 4, 2002, pp. 496-8. Between 1992 and 2000 there was a total of 30-42 oil producing JVs registered in Russia, with their output constituting just 3-9 percent of the Russian total. “Joint Ventures Add to Russian Oil Production,” Oil and Gas Journal, March 14, 1994, pp. 34-5; and Heinrich et al, p. 497.
Overall, while the fall of the command economy and privatisation of the 1990s hinted at a future period of foreign and private domination of the industry, the events in this decade point to the contrary.

Russia is important to the oil markets because it holds the world’s seventh largest oil reserves and it is the second largest oil producer and exporter. According to BP, in 2005 Russia had proven oil reserves of 74.4 billion barrels, most of which are located in Western Siberia, between the Ural Mountains and the Central Siberian Plateau, and on Sakhalin Island just north of Japan. In the 1980s, the Western Siberia region, also known as the ‘Russian Core’, made the Soviet Union a major world oil producer, allowing for peak production of 12.5 million bpd in 1987 and 1988, all but 1 million bpd of which came from Russia (see Table 3.1). Following the collapse of the Soviet Union in 1991, oil production fell precipitously, reaching a low of roughly 6 million bpd between 1996 and 1999 (Table 3.1 and Figure 3.1). Several factors are thought to have caused the decline, including the depletion of the country’s largest fields due to state-mandated production surges and the collapse of the Soviet central planning system that was exemplified in Soviet industrial ministry’s enormous financing and in the full control of the oil industry.

Table 3.1: Russia’s Crude Oil Production and Consumption (1985-2005)

<table>
<thead>
<tr>
<th>Year</th>
<th>Production (mbpd)</th>
<th>Consumption (mbpd)</th>
<th>Balance (mbpd)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1985</td>
<td>10.904</td>
<td>4.910</td>
<td>5.994</td>
</tr>
<tr>
<td>1986</td>
<td>11.306</td>
<td>4.972</td>
<td>6.334</td>
</tr>
<tr>
<td>1987</td>
<td>11.484</td>
<td>5.017</td>
<td>6.467</td>
</tr>
<tr>
<td>1988</td>
<td>11.444</td>
<td>4.967</td>
<td>6.477</td>
</tr>
<tr>
<td>1989</td>
<td>11.135</td>
<td>5.077</td>
<td>6.058</td>
</tr>
<tr>
<td>1990</td>
<td>10.405</td>
<td>5.015</td>
<td>5.390</td>
</tr>
<tr>
<td>1992</td>
<td>8.038</td>
<td>4.597</td>
<td>3.441</td>
</tr>
<tr>
<td>1993</td>
<td>7.173</td>
<td>3.875</td>
<td>3.298</td>
</tr>
<tr>
<td>1994</td>
<td>6.419</td>
<td>3.359</td>
<td>3.060</td>
</tr>
<tr>
<td>1996</td>
<td>6.114</td>
<td>2.686</td>
<td>3.428</td>
</tr>
<tr>
<td>1997</td>
<td>6.227</td>
<td>2.689</td>
<td>3.538</td>
</tr>
<tr>
<td>1998</td>
<td>6.169</td>
<td>2.554</td>
<td>3.615</td>
</tr>
<tr>
<td>1999</td>
<td>6.178</td>
<td>2.625</td>
<td>3.553</td>
</tr>
<tr>
<td>2000</td>
<td>6.536</td>
<td>2.583</td>
<td>3.953</td>
</tr>
</tbody>
</table>

271 For a relatively recent study of Russia’s oil and its political economy, written on the eve of Yeltsin’s rule see David Lane (ed.), The Political Economy of Russian Oil (London: Rowman & Littlefield, 2000); also see Falola and Genova, The Politics of the Global Oil Industry, chapter 14.

272 BP Statistical Review of World Energy 2006. According to a recent study by Dallas-based energy reserve auditors DeGolyer & NacNaughton, whose clients include leading Russian energy companies such as Gazprom and Yukos, Russia’s true recoverable reserves are between 150 and 200 billion barrels. Jason Bush, “Oil: What’s Russia Really Sitting On?” Business Week, November 22, 2004, p. 36.


274 Watson, “Foreign Investment in Russia,” p. 431.

275 Other factors in Russia’s declining oil output were the dislocation caused by the more general economic and political transformation in the region, in particular the breakdown of inter-republic trade (the bulk of the Soviet Union’s oilfield equipment was produced in Azerbaijan); the uncertainties of economic reform, battles over resource control, and the peculiar incentive structures faced by oil companies only partially independent from state control; low domestic oil prices, which both discouraged production and deprived the Russian oil companies of the money they needed to undertake investments; and the rapid contraction of the industrial sector, which reduced energy demand. Ibid, p. 452.
<table>
<thead>
<tr>
<th>Year</th>
<th>Production</th>
<th>Consumption</th>
</tr>
</thead>
<tbody>
<tr>
<td>2001</td>
<td>7,056</td>
<td>2,566</td>
</tr>
<tr>
<td>2002</td>
<td>7,698</td>
<td>2,606</td>
</tr>
<tr>
<td>2003</td>
<td>8,544</td>
<td>2,645</td>
</tr>
<tr>
<td>2004</td>
<td>9,287</td>
<td>2,714</td>
</tr>
<tr>
<td>2005</td>
<td>9,551</td>
<td>2,753</td>
</tr>
</tbody>
</table>

Source: BP Statistical Review of World Energy 2006

Figure 3.1: Russia’s Crude Oil Production and Consumption (1985-2005)

On November 17, 1992, President Yeltsin signed a decree establishing the first vertically integrated oil companies, and ordered the industry restructured.\(^{276}\) In addition, framework for PSAs was laid out in another presidential decree in December 1993, and the PSA Law was adopted by the Duma in December 1995, terms of which were further improved in February 1999.\(^{277}\) A turnaround in Russia’s oil production, which can be attributed to the privatisation of the industry and opening it up for foreign investment following the collapse of the Soviet Union, began at the turn of the century.\(^{278}\) In six years, between 1999 and 2005, Russian crude oil production grew by 3.4 million bpd (or 55 percent), but was still around 1.9 million bpd short of its 1987/88 peak. However, since average Russian oil consumption in the last ten years (approximately 2.6 million bpd) is slightly over half of what it was in the second half of 1980s (5 million bpd), as can be seen in Figure 3.1, Russian oil exports were larger in 2005 (6.8 million bpd) than during its peak production in 1987/88 (6.5 million bpd). Much of Russia’s oil exports head to Europe, with low, albeit growing share heading to the United States and East Asia.

Accordingly, in 2005, Russia was the world’s second largest producer and exporter of crude oil, behind only Saudi Arabia, and in the early years since the break-up of Soviet Union it became very important for the IOCs, as access to resources in the major OPEC countries remained closed. In 2004, oil and gas accounted for roughly 20 percent of Russia’s economy, 55 percent of

\(^{278}\) Mainly thanks to the new technologies, such as horizontal wells and computerised reservoir management systems, the recovery rates are increased dramatically. Bush, “Oil: What’s Russia Really Sitting On?”
its export earnings, and 40 percent of its total tax revenues. According to Moises Naim, “in the future, Russia’s oil (and gas) industry will become even more important, as no other sector can be as internationally competitive, grow as rapidly, or be as profitable.” In May 2003, the Russian government released its energy strategy to 2020, which designates the energy sector as the engine of economic growth. Both the Russian government and outside observers agree that production should continue to grow, at least in the short term, as oil companies in Russia are applying new upstream techniques to older oilfields and therefore improving current production.

It is uncertain however, that sustained improvements to exploration and development will continue in the medium and long term as the state is nationalising the private firms previously owned by the so-called oligarchs, such as Vladimir Potanin (who privatised Norilsk Nickel and SIDANCO), Mikhail Khodorkovsky (Yukos), Mikhail Fridman (Tyumen Oil), and Boris Berezovsky and Roman Abramovich (Sibneft). These and other men acquired the abovementioned firms in just four months through rigged auctions. These auctions were made possible by them bailing out Boris Yeltsin in the 1996 ‘loans for shares’ scheme, which allowed a destitute Russian state to pay back salaries and pensions, and which bought Yeltsin the political, financial, and strategic support of the future oligarchs in the upcoming presidential elections. When it came to dealing with the oligarchs, the government was generally unable to exercise much control, especially during Yeltsin’s rule. Since the state was very weak, the oligarchs who now owned and managed Russia’s most precious raw material assets, which were previously owned exclusively by the state, paid little or no taxes. This “gigantic scam” or “crooked giveaway” made Khodorkovsky and other new executives “dazzlingly wealthy almost overnight,” with no legal action taken against them despite some “inevitable shady dealings.” The oligarchs became owners of some of Russia’s most attractive assets, and big political actors in their own right. In 2000, Chrystia Freeland called the loans-for-shares scheme “so brazen

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280 Ibid. Naim goes on to suggest that Russia risks becoming a “petro-state.” This is highly debatable, as natural gas is as important in its export earnings as oil is, so if oil prices drop, Russia is not as vulnerable as other oil exporters, which do not export natural gas at the same time.


283 The loans for shares program began in 1994. Under this program, the government would allow private businesses (oligarch-owned banks) to manage the state stake in a group of key companies in exchange for loans. The government listed the loans as additional budget revenues, thereby appearing to reduce its budget deficit. Not able to pay back the loans, the state would auction off the right to manage its shares. This was supposed to be an open and competitive process, but in reality, it was dominated by insider deals and lobbying of the future oligarchs. This was how Khodorkovsky got a 78 percent share of ownership in Yukos, worth about $5 billion, for a mere $310 million, and how Boris Berezovsky got Sibneft, another oil giant, worth $3 billion, for about $100 million. The loans for shares scheme operated until September 1996. Hoffman, The Oligarchs, pp. 127-149; and Marshall I. Goldman, “Putin and the Oligarchs,” Foreign Affairs, vol. 83, no. 6 (November-December 2004), p. 35. An IMF report in 1998 estimated that 17 Russian oil and gas companies, with a fair market value of at least $17 billion, had been sold for a total of $1.4 billion. Engdahl, A Century of War, p. 237.

284 Freeland, Sale of the Century, p. 170.


and so bizarre that five years later it’s still hard to understand why the Russian government actually did it.” 289 Most importantly, Vladimir Putin viewed it as a costly mistake that must be reversed. 290

CASE STUDY 1: Vladimir Putin and the Oil Industry – From ‘Bandit Capitalism’ to ‘Statist Capitalism’ 291

Table 3.2: Goals of Main Actors in Russian Oil Industry Bargaining

<table>
<thead>
<tr>
<th>Actor</th>
<th>Bargaining Goals</th>
</tr>
</thead>
<tbody>
<tr>
<td>Vladimir Putin and the Russian government</td>
<td>Consolidation and government control of the industry in order to strengthen domestic power and Russia’s international position</td>
</tr>
<tr>
<td>Oligarchs</td>
<td>Challenging Putin politically; maintenance of control over their oil companies; low taxes</td>
</tr>
<tr>
<td>IOC’s</td>
<td>Easy and secure entry into Russia; low taxes</td>
</tr>
</tbody>
</table>

By the time Vladimir Putin succeeded Yeltsin in 2000, there was much to remedy. Putin does not believe the oligarchs are acting in Russia’s best interests, since he does not want the Russian economy to be dependent on the sale of raw materials, and therefore to fall prey to the ‘Dutch Disease’, or the ‘resource curse’ as some have suggested. 292 Instead, Putin believes that “the stable development of the Russian economy … needs to be based on the planned growth of its component parts, including in first place, the potential of its mineral resources …, which will serve as a guarantee of the country’s economic security.” Russia cannot simply be an exporter of raw materials but rather, “the development of the domestic processing industry … is the main source to turn Russia into a leading economic power with a high standard of living for the majority of the population in a relatively short period.” 293 Putin notes that this is not possible without the support of the state or without the development of “large financial-industrial corporations” that cut across economic sectors and “are able to compete on an equal basis with the West’s transnational corporations.” 294

One of Putin’s first steps as Russia’s President was to declare a change in the rules of the game, where oligarchs were no longer able to count on ‘special access’ to the Kremlin as during Yeltsin’s rule. 295 In July 2000, Putin told the oligarchs that he would not interfere with their businesses or re-nationalise their possessions as long as they “stayed out of politics.” 296 Limiting the oligarchs’ political involvement proved difficult, as many of them were tempted to expand their activities beyond business – for example to media, 297 and more importantly to politics. 298

289 Freeland, Sale of the Century, p. 170.
294 Ibid.
295 Goldman, “Putin and the Oligarchs,” p. 36.
296 Ibid.
297 Several, including Vladimir Gusinsky and Berezovsky, created media empires of television stations, newspapers, and magazines and used these outlets to attack not only each other, but also Putin, particularly for his policies in Chechnya and his inept response to the 2000 sinking of Kursk in the Barents Sea. Ibid.
298 Khodorkovsky was reported to have offered Russia’s two liberal parties, Yabloko and SPS, $100 million to unite and campaign together in opposition to Putin and his United Russia Party. Moreover, he broadly hinted that he would run for president in 2008 when Putin’s term is due to expire. Khodorkovsky also actively promoted
which Putin saw as “a danger and threat to the Russian state.”

Eager to export more oil, Mikhail Khodorkovsky, the CEO of Yukos, called for the building of new pipelines: one to the Arctic port of Murmansk (a base for exports to the United States), another through Siberia (toward Asian markets). For the latter, he favoured a pipeline to Daqing, China, despite the government’s preference for a route to the Russian Pacific port of Nakhodka, which would primarily serve Japan. Although both proposals were a direct challenge to Transneft, the state pipeline monopoly that owned and operated all of Russia’s pipelines, Khodorkovsky announced that he was prepared to build his own pipelines if necessary.

The fact that Putin appeared to have personally blessed the Tyumen Oil’s (TNK’s) merger with BP led some to hope that Putin’s rule would lead to new opportunities for Western oil investment in Russia. President Putin was supportive of Western investment in the Russian oil industry and actively encouraged Western investment in technologically challenging projects. He was also not against Western investment in Russian oil firms. Before Putin came to power, both the Russian oligarchs and the state favoured the idea that foreign companies invest in Russia, and the legislation on PSAs was entered into force in June 1996, after the Duma passed a PSA law in December 1995. The PSA law discussed license holders negotiating special terms without reference to whether they were Russian or foreign. While the 1995 PSA Law did not insulate foreign investors from frequent changes in legislation and from an unpredictable state bureaucracy, the 1999 improvement in legislation made PSAs the most attractive form of foreign investment in the Russian oil and gas industry. From 1999 to 2001, altogether 22 projects were made PSA-eligible with another 18 projects awaiting a vote in the Duma. It is important to note that Washington spent a great deal of time and effort pressing Moscow to grant broad scope for PSAs with IOCs, and based on Russia’s PSA legislation improvements in the late 1990s, its pressure clearly contributed to better terms for its IOCs. Russia’s relatively close relationship with the U.S. at the time helped the U.S. voice to be heard in the Kremlin.

However, the honeymoon between the Western oil industry and Putin ended in 2003, when PSA legislation was changed. Putin’s clear preference was for Russia’s policy on partnership with Western firms to evolve over time, setting the limits of what was, or was not, possible on a case-by-case basis through consultation rather than through the decisions of Russia’s oil magnates. For example, Putin argued in 1999 that there must be a fusion of the state and private sectors, which can be achieved by the creation of vertically integrated financial industrial groups

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300 Ibid.
301 For a good study of issues surrounding Transneft see Komori Goichi, “Issues Involved in the Russian Crude Oil Transportation System and the Role of the State-Owned Pipeline Company, Transneft,” The Institute of Energy Economics, Japan, August 2005.
307 Ibid.
308 Heinrich et al, “Foreign Investment in Russian Oil and Gas,” p. 500.
309 Barnes, “NOCs and U.S. Foreign Policy,” p. 23.
established with the assistance of the state. These industrial groups were to operate within the framework provided by the state, and have the explicit goal of developing Russian firms that are capable of competing on equal terms with Western multinationals.\textsuperscript{311} Therefore, in early 2003, the Duma adopted a law, which effectively scrapped PSAs. According to the Russian government, PSA Law caused a reduction in tax receipts from oil projects.\textsuperscript{312} Under the 2003 legislation, oil, gas or other natural resources must be offered, first in open tenders and only then, if no purchasers are found, re-bid on PSA terms.\textsuperscript{313} In other words, the government would treat PSAs as a special regime to be applied selectively on a case-by-case basis, and they are likely to be limited to complex and capital-intensive offshore projects.\textsuperscript{314}

Moreover, in mid-2003, the Russian procurator’s office began arresting Yukos executives, and although it could have been taken against any of the Russian oligarchs, Putin’s October 2003 action against Khodorkovsky and Yukos occurred due to Khodorkovsky’s direct involvement and interference in politics.\textsuperscript{315} The Kremlin’s seemingly sudden attack on private industry surprised the international business community that was expecting investment-friendly and cooperative behaviour from the Russian leadership. The publicly approved and supported arrest of Mikhail Khodorkovsky, however, triggered speculation that conditions in Putin’s second term may be even less advantageous to foreign investors. Khodorkovsky’s arrest came at a time when Yukos’ owners and managers were engaged in possible merger talks with senior executives from Chevron and Exxon Mobil,\textsuperscript{316} which alarmed siloviki and other hard-liners in the government.\textsuperscript{317} They feared that Putin would wake up one morning and discover that Russia’s most strategic and valuable energy companies had been taken over by Western corporations.\textsuperscript{318}

Khodorkovsky’s arrest accurately foretold a dramatic shift in how Russia planned to do business in the energy sector.\textsuperscript{319} “The demise of Russia’s most westernised oligarch”\textsuperscript{320} was widely viewed as a blow to outside investment, given his role as a major proponent of foreign involvement in the country’s energy industry.\textsuperscript{321} The confrontation between Khodorkovsky and Putin served as a defining event in the future development of Russia’s oil, effectively setting the terms and

\begin{thebibliography}{99}
\bibitem{315} Khodorkovsky was arrested on October 25, 2003 and was charged with violating seven articles of the Russian Federation Criminal Code, including personal income tax evasion, overseeing corporate tax evasion, non-compliance with a court judgment, falsifying documents, and theft. Russian Petroleum Investor, January 2004. For more on Putin’s crackdown of the oligarchs, see Anders Aslund, “The Hunt for Russia’s Riches,”\textit{ Foreign Policy}, vol. 152, January-February 2006, pp. 43-48.
\bibitem{317} Siloviki: “power people,” Russian politicians from the old security or military services, often the KGB and military officers or other security services.
\bibitem{318} It was one thing for the foreign companies to be minority investors, such as Conoco Phillips in Lukoil, but quite another for them to buy operational control, especially when some of their payments to the oligarchs were being diverted abroad (Abramovich’s $400 million into Chelsea Football Club for example). Goldman, “Putin and the Oligarchs,” p. 40.
\bibitem{319} Ibid. p. 2.
\bibitem{320} “The Tycoon and the President,”\textit{ The Economist}.
\end{thebibliography}
conditions of future Western investment. Signs of this shift were visible even before the March 2004 presidential elections. In January 2004, the Russian government announced that it wanted over $1 billion for a license to explore and develop one of the three Sakhalin-3 parcels, Kirinsky block, the rights to which would be won through a tender process. This decision effectively annulled the results of a 1993 tender, in which Exxon Mobil, Chevron and Rosneft received the same exploration rights. It was a particular blow to Exxon Mobil, which had already invested over $80 million in the project, and had been withholding further investment in the project in the hopes of being able to develop it through a PSA.

After the presidential elections of 2004, signs began to emerge that the events of 2003 and early 2004 were no aberration but rather the calculated implementation of a plan and vision for the future of the Russian oil sector. President Putin was not going to use his increased political power simply to ‘open the door’ for foreign investment in the Russian oil and gas industry. Rather, he intended to reorganise the Russian oil and gas industry to enhance the power of the Russian state, as “privatisation and competition” made “it increasingly difficult for Russia’s oil industry to identify a single national interest or to behave, like OPEC’s members, as a coherent unit.” It thus came as no surprise when in April 2004 the Duma passed new oil taxes that raised revenues when crude prices were high. The new export duties, which took effect in August 2004, work on a sliding scale that hands the state the lion’s share of any gains in the oil price over $25 a barrel. These changes indicated the state’s willingness to take aggressive steps to increase its share of oil profits at the expense of oil companies and to expand its control over the oil sector. Moreover, Russian government’s February 2005 decision to ban majority foreign participation in new natural resource concessions removed the welcome mat to the outsiders and to any new PSAs. Thus, currently, while Russia does allow foreign investment, the legal and tax structure strongly favour ownership by domestic firms.

It remains questionable if BP would now be able to conclude the deal in which it bought half of TNK, and what to date has been the largest foreign oil presence in Russia. This is particularly so when one considers that in April 2005 Russian government presented TNK-BP with an arbitrary $936 million tax bill, which TNK-BP's vice president Peter Henshaw believes “can be negotiated down,” by going “through it with the tax authorities.” The belated tax bill was all too reminiscent of the tactics used to dismember Yukos, whose key production assets were

323 Ibid, p. 2.
324 Sakhalin-3's Kirinsky block, the largest of the project’s three blocks with estimated reserves of 3.32 billion barrels of extractable oil and 700 billion cubic meters of gas. Valeria Korchagina, “Energy Minister Says State is Seeking $1 Billion for Exxon Sakhalin-3 License,” St. Petersburg Times, February 6, 2004.
325 A 1993 tender for development on Sakhalin Island by an Exxon Mobil-led consortium was suddenly revoked after the consortium was accused of failing to invest as much as it had promised. Goldman, “Putin and the Oligarchs,” p. 43. When Exxon Mobil realised that this project would not be added to the list of those eligible for production-sharing agreements by the Duma, they were prepared to develop it under ordinary licensing terms. However, by then ten years had elapsed since the initial agreement, providing the loophole for the Russian government to annul the agreement. Olcott, “Vladimir Putin and the Geopolitics of Oil,” p. 2.
329 “A Survey of Oil,” The Economist, April 30, 2005, p. 10. Tax bill was for back taxes dating from 2001, when the Russian partner in the venture, Tyumen Oil, took advantage of tax havens that were then widely assumed to be legal. Jason Bush, “Mixed Messages from the Kremlin,” Business Week, May 2, 2005, p. 28.
330 Ibid, p. 29. Under the 2003 deal, when BP purchased 50 percent of Tyumen Oil for $7.7 billion, according to John Browne the British energy giant has been indemnified for any tax claims from the pre-BP era. Schwartz, “Putin Gives Big Oil the Cold Shoulder.”
331 Ibid.
confiscated by the state in order to settle old tax claims. Finally, the Duma has been considering legislation that would make it much harder for non-Russian companies to explore new oilfields and that makes Conoco Phillips’s $2 billion investment in Lukoil extremely risky, although it has been touted as an “example of a good partnership between the private sector and the state.”

Thus, following legislative changes, Exxon Mobil is on the verge of losing its license to explore a fresh area around Sakhalin Island off Siberia ($17 billion Sakhalin-1 field), with Russian bidders angling to take over. Moreover, Russia’s Academy of Natural Science recommended that the state takes majority control of Royal Dutch/Shell’s, 55 percent owned and $22 billion worth, Sakhalin-2 field, the Kharyaga license held by Total, together with Exxon’s abovementioned Sakhalin-1, because they were all behind schedule. In September 2006, Russia’s Natural Resources Ministry withdrew its approval of Royal Dutch/Shell’s Sakhalin-2 permit, and revoked the license on environmental grounds, although the construction work on the development of the field was 75 percent complete and due to come fully on stream by 2008. Moreover, in December 2006, Russia suspended vital permits for Sakhalin-2 venture, and Royal Dutch/Shell had to give up its controlling stake in the project, handing Gazprom 50 percent plus one share interest. “The doors are definitely closing,” according to Sanford Bernstein, an analyst fromNeil McMahon. That is a particularly painful loss for majors, such as BP, Royal Dutch/Shell, Exxon Mobil and Chevron, who are desperate to increase their production but are already shut out of state-dominated oil industries in countries such as Kuwait and Mexico.

Initially, IOCs did not appear as the only oil companies discouraged from participating in the Russian oil industry, as in 2002 Moscow blocked a Chinese attempt to take a 75 percent stake in Slavneft, a state-controlled energy firm. However, signs of this changing emerged in November 2006, when Rosneft and Sinopec signed a deal to buy Udmurtneft, a Russian oil company. In addition, in late 2006, a partnership between Rosneft and Sinopec has resulted in a first exploration well on the Sakhalin-3 block, offshore Sakhalin Island. This is the first time the two countries have cooperated in an upstream oil project on Russian territory.

—Shell is also facing court action and fines for alleged environmental infractions and has lost a $300 million second bank loan for the project. Oil & Gas Journal, January 2, 2007, p. 29.
—Chevron’s boss, David O’Reilly, has talked about Russia as one of the firm’s key growth areas. “Promising Whispers,” The Economist.
—“Rosneft, China’s Sinopec Sign Deal to Buy Russian Oil Company,” RIA Novosti, November 17, 2006.
Ever since Putin launched his crackdown against Yukos, the Russian state has been steadily reasserting its control over the country’s vast oil reserves. As of February 2006, state-owned companies produced about 30 percent of Russia’s oil, and of late 2005 Kremlin directly owned 57.4 percent of Russia energy sector. Putin’s oil industry consolidation is evident in the fact that Gazprom and Rosneft, Yukos, and Sibneft are now de facto controlled by the Russian government (see Table 3.3). In addition, Lukoil, the largest Russian oil group, and Surgutneftegaz, the fourth largest crude oil producer in Russia are both Kremlin-friendly private operators, with “close ties to the state.” Lukoil has always acted in close coordination with Kremlin, often presenting itself as a faithful servant of state, and, even if it maintains its private ownership in future, it will increasingly act at the behest of the government.

Table 3.3: Main Russian Oil Companies and Their Ownership, Reserves and Production (2005)

<table>
<thead>
<tr>
<th>Company</th>
<th>State Ownership</th>
<th>Private Ownership</th>
<th>Reserves (billion barrels)</th>
<th>Production (mbpd)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lukoil</td>
<td>Very close to Kremlin</td>
<td>Conoco Phillips 19%</td>
<td>16.0 (crude oil) 20.1 (incl. n. gas)</td>
<td>1.79 1.88 (incl. n. gas)</td>
</tr>
<tr>
<td>Gazprom</td>
<td>73%; including Yukos’ gas assets</td>
<td></td>
<td>18.4 (crude oil) 195.9 (incl. n. gas)</td>
<td>0.91 10.38 (incl. n. gas)</td>
</tr>
<tr>
<td>Rosneft</td>
<td>100%; including</td>
<td></td>
<td>15.0 (crude oil) 19.4 (incl. n. gas)</td>
<td>1.99 2.15 (incl. n. gas)</td>
</tr>
</tbody>
</table>

344 According to figures released by the Moscow-based Novosti agency.
345 Kremlin paid $6 billion through Rosneft in June 2005 to achieve majority stake. Meanwhile, a proposed merger between Gazprom and Rosneft has been cancelled by the Russian government. The Russian government has announced its intention to increase its stake in Gazprom but its stake will be reduced and will allow the Russian government to obtain majority control of Gazprom. The Russian government currently holds a 100 percent interest in Rosneft. “Russia Cancels Rosneft, Gazprom Merger,” Oil and Gas Journal, vol. 103, no. 20, May 23, 2005, pp. 36-7. For more on Gazprom, see “Energy Tsar,” Forbes Asia, July 24, 2006, pp. 55-60. For more on Rosneft, see Nina Poussenkova, “Lord of the Rigs: Rosneft as a Mirror of Russia’s Evolution,” paper prepared in conjunction with an energy study sponsored by Japan Petroleum Energy Center and the James A. Baker III Institute for Public Policy, Rice University, March 2007.
346 On December 19, 2004, Yuganskneftegaz, which accounted for 60 percent of Yukos’s oil production capacity, was sold by the government for $9.35 billion, ostensibly to pay some of Yukos’s huge tax bill (of $21 billion). The sale was to Baikal Finance Group, a hitherto unknown firm, which was three days later bought by Rosneft, a state-owned oil company for an undisclosed sum. Thus, the state took back Khodorkovsky’s prime asset in a way not unlike that in which he acquired his wealth in the first place. Rosneft, a fully state-owned company, unlike Gazprom, which was initially expected to buy Yuganskneftegaz, should enjoy sovereign immunity against any court rulings based on Yukos’s protection of firm’s assets while filing for bankruptcy. “Method and Madness,” The Economist, January 1, 2005, p. 53; “The Bell Tolls,” The Economist, November 27, 2004, p. 74.
347 72.7 percent of Sibneft was bought by Gazprom in late September 2005 for $13.7 billion; since, Sibneft changed its name to Gazprom Neft. There were indications that Abramovich’s Sibneft will be taken by the government-controlled companies ahead of September 2005, especially since Yukos owned 34.5 percent of Sibneft. Moreover, in 2003, “Sibneft has paid taxes on only 7 percent of its profits, less than a third of the statutory rate and half of what Yukos paid” (Goldman, “Putin and the Oligarchs,” p. 43). It was also argued, “Sibneft may yet face a back-tax bill of its own” (“Method and Madness,” The Economist), and that “Gazprom is lining up more than $10 billion in financing to try to get control of Sibneft.” (Heather Timmons, “Gazprom Preparing Battle for Oil Producer,” The New York Times, August 18, 2005).
<table>
<thead>
<tr>
<th></th>
<th>Yukos’ oil assets</th>
<th>Fridman 50%; BP 50%</th>
<th>4.3</th>
<th>1.55</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td>1.69</td>
<td>incl. n. gas</td>
</tr>
<tr>
<td>TNK-BP</td>
<td></td>
<td>1.0%; Very close to</td>
<td>6.6</td>
<td>1.28</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Kremlin</td>
<td>8.7</td>
<td>1.53</td>
</tr>
<tr>
<td>Surgutneftegas</td>
<td></td>
<td>Local government</td>
<td>4.1</td>
<td>0.49</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>4.4</td>
<td>0.51</td>
</tr>
<tr>
<td>Tatneft</td>
<td></td>
<td>Local government</td>
<td>n.a.</td>
<td>0.49</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>0.51</td>
</tr>
<tr>
<td>Slavneft</td>
<td></td>
<td>76%</td>
<td></td>
<td>0.362</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>0.368</td>
</tr>
<tr>
<td>Bashneft</td>
<td></td>
<td>Local government</td>
<td>n.a.</td>
<td>0.362</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>0.368</td>
</tr>
</tbody>
</table>


Signs of government’s oil industry consolidation came in early 2005, when Deutsche Bank advised Gazprom, Russia’s state-controlled gas monopoly, to buy several of the largest private domestic oil companies.\(^{350}\) Deutsche Bank, hired by Gazprom to advise it on the strategic development of its oil business, suggested that the state monopoly in effect, should renationalise the Russian oil industry by swallowing the main production asset of Yukos, the embattled oil company, as well as Sibneft and Surgutneftegas, two privately owned groups.\(^{351}\) Valery Draganov, head of the parliamentary committee for economic policy and a member of the pro-Kremlin United Russia party, said the recommendations reflected the general strategy of the Russian government: “Today there is consensus that natural resources must be controlled by the state and managed for the good of the whole country.”\(^{352}\)

Thus, experts predict that in the future, Rosneft, lead by Igor Sechin, Putin’s deputy chief of staff as the chair of the board, and Gazprom, headed by Putin’s St. Petersburg cronies Alexei Miller and Dmitri Medvedev, the First Deputy Prime Minister, as the chair of the board, would seek to expand further by acquiring other companies in future.\(^{353}\) Thus, the future of TNK-BP consortium is far from certain,\(^{354}\) as “Yukos would not be the last company to find itself under attack.”\(^{355}\) There is intense speculation that in 2007 a deal will be brokered allowing Gazprom to replace Russian shareholders that own 50 percent of TNK-BP, and that Surgutneftegaz may also soon be victim of state incursion.\(^{356}\) The government, according to an industry expert, “has set its sights on Slavneft, Surgutneftegaz, at least half of TNK-BP and whatever is left of Yukos,” thus

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\(^{350}\) “Gazprom Urged to Buy Russian Oil Companies,” *Pipeline & Gas Journal*, vol. 232, no. 1, January 2005, p. 16

\(^{351}\) Ibid.

\(^{352}\) Ibid.

\(^{353}\) “Russia: Energy Overview.”

\(^{354}\) BP should be worried about the $7 billion it has already invested in a partnership with Tyumen Oil, a company that has been accused of misbehaviour similar to Yukos’, including abuse of the legal system, unfair payment for state resources, and tax delinquency. The partnership itself has also been charged with violating the official state secrets act by disclosing the extent of the country’s petroleum reserves. Goldman, “Putin and the Oligarchs,” p. 43.


\(^{356}\) Goldman, “Putin and the Oligarchs,” p. 43.
enabling it to gain control up to 60 percent of crude oil production in near future.\textsuperscript{357} A further indication of this came when on 1 August 2006, amid almost record-high oil prices, the Moscow Arbitration Court declared bankruptcy and liquidation of Yukos, assets of which were in late March 2007 auctioned at well below market rates to Kremlin-controlled companies, Rosneft and Gazprom, first of which then became Russia’s biggest oil producer (Table 3.2).\textsuperscript{358}

Some have suggested that the government aims to create one big state-controlled conglomerate (“Gosneftegaz’), composed of Gazprom, Rosneft, Surgutneftegaz, Lukoil, Yukos, Sibneft, and possibly TNK-BP. According to this view, the mega-company would emerge by 2008, before the next Russian presidential election, with Putin as its head.\textsuperscript{359} This company, rivalling Saudi Aramco in size, would be an even stronger foreign-policy instrument for the government than Gazprom and Rosneft are now. As of early 2007, we are not too far from this suggestion becoming a reality, as Gazprom and Rosneft are on the way to becoming the world’s top energy suppliers, and a dominant force in oil and gas.

After Yukos affair, other private companies “suddenly started to like paying taxes,” as the government is paying closer attention to company activities at times of increased tax burden on the energy industry triggered by high energy prices. For example, Sibneft’s share of profit paid in taxes to the state grew from 7 percent in 2003 to 25 percent in 2004, Lukoil’s from 24 to 25.2 percent, TNK-BP’s from 7.5 to 16.5 percent, and Surgutneftegaz’s from 19 to 22 percent respectively.\textsuperscript{360} Another lesson from the Yukos case is that “oil companies must ‘make friends’ with the state and demonstrate their loyalty to the government.” This concerns large mergers and acquisitions, entry into new regions, extending guarantees for future government transportation and export routes and many other issue areas where the paths of oil companies and government cross.\textsuperscript{361}

Russia’s oil and gas reserves serve as a source of income for reinvestment in the country’s economy and provide an attractive lever for use in Russia’s foreign relations,\textsuperscript{362} and thus, foreign control of Russia’s oil is a step that the Kremlin will not allow. However, since Russia will be unable “to provide additional significant financial revenue from the country’s budget for large state investment in its own processing industry” in the immediate future, Putin supports the idea of state-sponsored foreign investment in Russia’s extractive industries. These, properly managed large-scale investments, including foreign capital, allow the state to earn hard currency from the export of its natural resources.\textsuperscript{363} This may be the only way into Russia for IOCs. It is virtually inconceivable that the Western energy firms will be welcome bidders for any of the Russia’s strategic energy assets.\textsuperscript{364} Even if they enter, for each dollar of price above $25 a barrel, since 2005 Russia took 89 percent in taxes, up from 68 percent in 2003. These levies deter costly, risky investments.\textsuperscript{365}

Only after the reorganisation of oil industry is complete and the state’s capacity to protect national interests in this strategic sector is affirmed, will Western companies be ‘invited’ in to

\begin{itemize}
  \item Glada Lahn and Keun-Wook Paik, “Russia’s Oil and Gas Exports to North-East Asia,” Energy Politics, no. 7, Fall 2005, p. 75.
  \item Ibid, p. 6.
  \item Olcott, “Vladimir Putin and the Geopolitics of Oil,” p. 3.
  \item “Luk Warm,” The Economist.
  \item “Open Season on Big Oil,” Business Week, p. 42.
\end{itemize}
participate, albeit in a very limited way, in the Russian oil industry. \(^{366}\) It is clear then that the primacy of the Russian state in the country’s energy sector is non-negotiable. While Putin recognises the importance of market forces and the need to protect private property, he believes that both must be managed to ensure that neither takes precedence over the interests of the state, which exercises its control in the name of the Russian people, a vast majority of whom support Putin’s re-nationalisation of the oil industry. \(^{367}\)

Even if they were to re-enter Russia’s oil industry, IOCs would most likely find some staunch competition. Andrey Kokoshin, the head of the committee on the Commonwealth of Independent States (CIS) affairs at the Russian parliament, argues, “Russia can accept the offers coming in from London, Frankfurt or New York – or from Beijing, Hong Kong or New Delhi.” \(^{368}\) Energy reserves, and options of where to direct them, give Russia considerable bargaining power in its relations with other actors in the oil industry.

**Outcome**

For Putin, the oil industry bargaining aim was to reassert state control over ‘strategic resources’ and gain primacy over the main pipelines and market channels through which it ships its hydrocarbons to international markets. \(^{369}\) Vladimir Putin is therefore methodologically consolidating state control over Russia’s energy resources and deploying them as a tool of international statecraft, and the vehicle for his aspiration that Russia re-emerges as a global superpower. \(^{370}\) Bargaining between Putin and Russian oligarchs resulted in Putin’s triumph and in consolidation of the oil industry. The oligarchs and IOCs are on the losing end of the bargain.

**Analyses and Conclusions**

Boris Yeltsin’s rule in the 1990s indicated that the oligarchs and IOCs would have it their way. Their bargaining victory was evident in oligarchs’ cheap acquisition of most of Russia’s oil industry. Further, it was evident in the legislation on production sharing agreements, which was entered into force in June 1996, and which discussed license holders negotiating special terms without reference to whether they were Russian or foreign. \(^{371}\) This ‘national treatment’ legislation opened Russia’s oil industry to IOCs. However, the initial bargain slowly obsolesced after Putin became president, and consolidated his rule. Under Putin, the relationship between Russian business and the state swung between the two extremes. In 1998/99, during Yeltsin’s presidency, both federal and regional authorities were under the control of ‘oligarchic capital’, and the relation between business and the state was characterised by the so-called ‘privatisation of the state’ (or ‘state capture’). By 2003/04 Russia under Putin had made a rapid shift to the dominance of the state over big business. \(^{372}\) In addition, Khodorkovsky’s arrest was a blow to outside investment, given his role as a major proponent of foreign involvement in the country’s

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energy industry, and Russian government’s February 2005 decision to ban majority foreign participation in new natural resource concessions removed the welcome mat to IOCs.

Why did Putin decide to control and consolidate Russia’s oil industry? He did not believe the oligarchs were acting in Russia’s best interests, and wanted to control the industry, which was to become a driving force to Russian economic recovery and an important bargaining asset internationally. Russian ownership of Russia’s resource base was deemed critical to Russia’s economic recovery and to the country’s re-emergence as an important international actor. Putin’s following statements support my argument that energy security equals Russian national security, and that Kremlin will not shy away from making energy a significant tool of its foreign policy:

The state has the right to regulate the process of the acquisition and the use of natural resources, and particularly mineral resources, independent of on whose property they are located.373

[Russia] must aspire to claim world leadership in the realm of energy.374

Additionally, Putin made a tacit bargain with the oligarchs when in July 2000 he told them that he would not interfere with their businesses or re-nationalise their possessions as long as they “stayed out of politics.”375 Khodorkovsky, who is in prison, and others, who are in exile,376 interfered in politics and by openly challenging Putin violated the bargain he had offered them. Hence, in order to consolidate his rule, Putin arrested Khodorkovsky, the one who challenged him the most, in order to discipline and reduce the power of the other oligarchs. Therefore, this factor is also an important one in determining the outcome of oil bargaining between Putin, the oligarchs and IOCs, who were Khodorkovsky’s main allies.

While IOCs showed considerable interest in Russia following privatisation, their opportunity for entry has been reduced by recent developments in the Russian oil industry. At present, the primary mechanism through which IOCs can get involved in the Russian oil industry is through the creation of JVs; the other forms of entry, such as shareholding or PSAs encounter serious obstacles. For example, under Russian PSA law only 30 percent of Russian oil reserves can be developed under the PSA regime. However, already in 2000, the 21 projects eligible for a PSA accounted for 28 percent of Russian oil resources.377 Although at the time there was hope among IOCs that this will be changed to allow larger share of Russian reserves to be developed under the PSA regime, this is nowadays nigh on impossible, and the use of the PSA is slowly becoming an exception.378 To be sure, PSAs were never intended to form the basis for the fiscal regime in Russia’s oil sector, and were seen as a transitional arrangement to facilitate early investment while the country developed its tax code and regulatory framework.379 Illegitimate privatisation of Russian oil industry and the State’s wish to regain the control of oil industry in order to use it to fulfil its economic and foreign policy objectives restricts the IOC entry to Russia. Besides government’s attempt at controlling and consolidating the oil industry, the remaining Russian private oil companies, such as Lukoil or Surgutneftegaz, do not see interest in new arrival of

375 Goldman, “Putin and the Oligarchs,” p. 36.
376 Berezovsky and Gusinsky.
IOCs. They believe that they can reach the very optimistic production targets that they have fixed themselves for 2010 from existing deposits, with limited investment in improvement of techniques used. Ergo, the conditions of access to resources for IOCs are becoming harder, and since the Russian government must approve any major international investment, it is unlikely that the Russian state will favour any significant penetration by IOCs into Russian oil industry.

The February 2005 decision to ban majority foreign participation in new natural resource concessions weakened the bargaining position of IOCs. The Russian government’s decision is legitimate and does not violate any international rules, norms, or principles, and, as such, no actions can or should be taken against Russia. Foreign investment in Russia’s oil industry, although limited, is still welcomed, and desperate foreign IOCs, just as Russia’s remaining oligarchs, should play the Kremlin’s game if they wish to maintain their possessions and limited presence in Russia. The Western governments and IOCs acquiesced to the destruction of Yukos, and now appear ready to play by the Kremlin’s rules. However, IOCs are not likely to make large investments in the Russian oil sector. Although Washington was successful in pressing Moscow to grant broad scope for PSAs with IOCs during Yeltsin years, any international and particularly American pressure against Putin’s government would have caused IOCs more harm, and would have further compromised their bargaining position, which is weakened after defeat in Russia.

Relationship with Hypotheses

The case study of contemporary bargaining in Russia’s oil industry has direct relevance to three of the hypotheses set in Chapter 2. Evidence presented in this case study is supportive of hypothesis one. Due to their weak bargaining power, the IOCs have been on the losing side of their bargain with Russia in the current decade and we are witnessing the obsolescing bargain in Russia. Moreover, although this case study is not the main determinant of the validity of the third hypothesis, when considering that in November 2006 Rosneft and Sinopec jointly purchased a Russian oil company and their partnership also resulted in a first exploration well on the Sakhalin-3 block, one can suggest that in Russia, the Chinese NOCs are gaining bargaining power at the IOCs’ expense. Finally, this case study has relevance to hypothesis four. Although the interests of American IOCs and the U.S. Government are aligned, the U.S. Government supported American IOCs in bargaining with Russia only in the 1990s, and not after Putin came to power. In the 1990s, U.S. government’s support resulted in improved investment legislation in Russia. However, since there has been no government support for American IOCs after Putin came to power and after the overall Russo-American relationship deteriorated (see analyses in the next case study), American IOCs lost bargaining power vis-à-vis the Russian government. This will be elaborated on in Chapter 7, when I discuss my findings.

381 “Every State has and shall freely exercise full permanent sovereignty, including possession, use and disposal, over its wealth, natural resources and economic activities.” Each State has the right: (a) To regulate and exercise authority over foreign investment within its national jurisdiction in accordance with its laws and regulations and in conformity with its national objectives and priorities… (b) To regulate and supervise the activities of transnational corporations within its national jurisdiction and take measures to ensure that such activities comply with its laws, rules and regulations and conform with its economic and social policies. Transnational corporations shall not intervene in the internal affairs of a host State… (c) To nationalise, expropriate or transfer ownership of foreign property….” Charter of Economic Rights and Duties of States, UN General Assembly Resolution 3281 (XXIX), December 12, 1974.
382 The moves by western oil companies to collaborate with Russian firms have been driven by the buyers’ interest in gaining the “booked” discoveries of the purchased company without the expense or risk of actual exploration. Roberts, The End of Oil, p. 172.
383 Torbakov, “Yukos Bankruptcy.”
CASE STUDY 2: Pipeline Bargaining – ‘The Scramble for Siberia’

Until recently, Russia had little or no access to East Asia’s lucrative energy markets due to the lack of infrastructure in East Siberia and the Russian Far East. However, with rapid growth of China, and perceptions there of a potential hostage situation, in which the U.S. would block supply routes from the Middle East to East Asia, the diversification of energy sources has become one of the priorities of China’s energy policy. In Japan, it has been high on agenda for decades, albeit for different reasons. Russia’s East Siberia and Far East have ample oil and gas reserves, which could replace a share of Chinese and Japanese Middle Eastern oil and gas exports, and the three-way ‘game’ for prioritised construction of pipelines has emerged.

Table 3.4: Goals of Main Actors in Russian Pipeline Bargaining

<table>
<thead>
<tr>
<th>Actor</th>
<th>Bargaining Goals</th>
</tr>
</thead>
<tbody>
<tr>
<td>Putin and the Russian government</td>
<td>Government controlled construction of pipelines; seeking to serve both Japan and China, yet relationship with China more important</td>
</tr>
<tr>
<td>The government of the People’s Republic of China (PRC)</td>
<td>Importance of diversifying oil sources from the Middle East; in order to maintain high economic growth and therefore domestic stability, need for more imported oil to fuel the economy; Russia seen as a crucial source</td>
</tr>
<tr>
<td>The Japanese government</td>
<td>Attempt to diversify sources of oil; Russia an obvious choice</td>
</tr>
<tr>
<td>Russian private oil companies</td>
<td>Constructing pipelines in private deals with foreign governments, NOCs and/or IOCs without government intervention</td>
</tr>
</tbody>
</table>

In May 2003, when Yukos’ head, Mikhail Khodorkovsky, signed an agreement with CNPC, China thought it had struck a deal with Russia to build a 2,260 km oil pipeline from Angarsk in eastern Siberia to the Chinese oil city of Daqing, where Russian oil would then be refined. The $2.5 to 4.0 billion project would help to feed China’s “growing hunger for energy that only foreign supplies can satisfy,”\(^\text{384}\) reduce its dependency on Middle Eastern oil and the vulnerability to American disruption of supply lines,\(^\text{385}\) and be a symbol of the new friendship established between the former enemies.\(^\text{386}\)

In 2002, China overtook Japan as the world’s second largest oil consumer, and in the following years, its oil imports surged by 30 percent in 2003, and 37 percent in 2004.\(^\text{387}\) Given that Russia is the world’s second largest oil exporter, the idea of a pipeline linking the two seems logical, even more so given the strategic partnership that Boris Yeltsin and Jiang Zemin affirmed in April

\(^{384}\) “In the Pipeline,” The Economist, May 1, 2004, p. 29.

\(^{385}\) “China imports about 60 percent of its oil from the Middle East. … Tankers carrying oil to China from the Middle East must pass through chokepoints that leave China vulnerable to blockade by the U.S.,” Clay Chandler, “Can China Keep the Lights On?” Fortune, February 23, 2004, p. 50; the objective of China’s energy security activities is to reduce the vulnerability of China’s oil supply in the face of American power, as the U.S. controls the sea routes leading from the Persian Gulf to the East Asian ports, particularly the Strait of Hormuz and the Malacca Straits. For more on China’s energy security see David M. Lampton and Richard Daniel Ewing, The US-China Relationship Facing International Security Crises (Washington D.C.: The Nixon Center, 2003); and Strecker Downs, China’s Quest for Energy Security.


1996. In February 1999, after two countries almost completely settled their border issues, Prime Ministers Yevgenii Primakov and Zhu Rongyi signed a framework agreement to investigate the export of oil and gas, and Yukos, Transneft and Sinopec signed a trilateral agreement to build a Siberian pipeline to China. Moreover, in July 2001, President Jiang Zemin signed an agreement in Moscow for a feasibility study of a pipeline from Angarsk to Daqing, which was finished in July 2002, and in May 2003 Khodorkovsky and CNPC signed an agreement that seemed to have sealed the deal. China was also interested in building a 4,000 km line to import natural gas from the Kovykta fields, being developed by the TNK-BP consortium. In short, according to Anders Aslund, “relations between China and Russia have never been better since the time of Mao and Stalin, from 1949-1953.”

Similarly, Alexander Lukin argues that relations between the two states were at an all-time high.

However, in September 2003, China became worried that its newly found ‘friend’ was seduced by a rival scheme proposed by Japan. This became evident in Russia’s Prime Minister Mikhail Kasyanov’s statement after talks with his Chinese counterpart, Wen Jiabao, in Beijing, where he said, “Russia would uphold its commitments to supply oil to China,” by delaying consideration of the pipeline to Daqing for three to four months to “assess the environmental impact.” He offered no assurance that Russia would reject the proposal that Japan has been lobbying for: to make the pipeline bypass China and terminate in Nakhodka, the nearest Russian port to Japan. This pipeline, to be the world’s longest and most expensive, would be almost as twice as long (3,700 km – 4,180 km), would cost more than twice as much as China’s ($5-15 billion according to various estimates), but it could also deliver more oil (1-1.6 million bpd versus 0.6-1.0 million bpd for Daqing route). The pipeline to the Pacific would also give Russia access to a wide range of markets – Japan, South Korea, USA, and China (See Figure 3.2 for pipeline proposals). Meanwhile, China’s proposal would provide quicker returns: the pipeline would be operational three to five years earlier than the Nakhodka route. Both China and Japan have suggested that branch lines could be attached to their proposed pipelines to satisfy the needs of

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390 Rutland, “Pipeline Pirouette in Northeast Asia.”


393 “Your Pipe or Mine?” The Economist.


395 “Your Pipe or Mine?” The Economist. By using the Chinese route, Russia would be gambling on a single market. The Nakhodka scheme is also seen as a potential boost to the development of the Russian Far East, especially since Japan “promised some $12 billion in business investment in Russia.” “The Great Oil Hunt,” Business Week, November 15, 2004, p. 30. Also see Sergei Blagov, “Russia Walks Thin Line between Japan and China,” Asia Times, August 1, 2005. For more on Russia’s vulnerability on single export market for a particular oil pipeline, see Isabel Gorst, “Russian Pipeline Strategies: Business versus Politics,” James A. Baker III Institute for Public Policy of Rice University, October 2004.

396 “Your Pipe or Mine?” The Economist.
each country, providing that Russia had enough oil to service them, which is doubtful. Nevertheless, whichever country gets the preferential deal would put its own needs first.

Figure 3.2: Chinese and Japanese Pipeline Proposals

Peter Rutland argued that two forces derailed the China plan, one domestic and one international. CNPC’s partner in the Daqing pipeline was none other than Khodorkovsky’s Yukos. As shown in the previous case study, late in 2003 the Kremlin launched an assault on the company that led to the arrest of its top owners and its near-bankruptcy. Yukos’ Daqing project stimulated a powerful counter-proposal from a coalition of rival energy companies. Keun Wook Paik explained how state-owned Transneft, whose monopoly on oil export pipelines was threatened by the Yukos project, first raised the idea of a pipeline to Nakhodka in August 2002. In February 2003 Gazprom and Rosneft joined forces to propose building parallel oil and gas pipelines to Nakhodka. Gazprom planned to tap their Chayandinskoe oil field in the republic of Sakha — and not the BP Kovykta field.

Second, Japan entered the game. During his visit to Moscow in January 2003, Prime Minister Junichiro Koizumi promised $5 billion in Japanese financial support for the Nakhodka pipeline. Bargaining continued through the spring. Citing that the Angarsk oil reserve was not large enough to sell oil to both China and Japan, then-Russian deputy Foreign Minister Alexander Losyukov said in mid-April 2003 that Russia had rejected a Japanese proposal to construct a trans-Siberian pipeline to provide Japan with oil, and would instead build a shorter pipeline to Daqing. In May 2003, Japan dropped its request for Russian government’s financial guarantees and agreed to contribute another $7 billion to help develop the oilfields. In June 2003, Putin said that the Pacific pipeline “looks preferable because it allows broad access to markets.” In July 2003, Japan dispatched a delegation, led by Iwao Okamoto, director-general of the Natural

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397 “In the Pipeline,” The Economist. Promising though eastern Siberia’s oil resources appear to be, they have yet to be tapped commercially. Even to be sure of filling the original proposed pipeline to Daqing, Russia would have to depend initially at least on supplies from the better-developed fields of western Siberia; also see Bahgat, “Russia’s Oil Potential: Prospects and Implications,” p. 144.
398 “Your Pipe or Mine?” The Economist.
399 Rutland, “Pipeline Pirouette in Northeast Asia.”
400 Cited in ibid.
401 Ibid.
Resources and Energy Agency, to Moscow. The Japanese energy officials discussed with their Russian counterparts about providing financial and technical assistance to the construction of the Pacific pipeline and the development of oilfields in eastern Siberia. The Japan Bank for International Cooperation was said to be willing to finance the construction project even without any loan guarantees from the Russian government. Following a year of heavy Japanese lobbying, on 14 May 2004, the heads of Gazprom, Rosneft and Surgutneftegaz reaffirmed their commitment to common routes for oil and gas pipelines to Nakhodka.

In September 2004, in what at the time seemed to be the final decision, when Wen Jiabao visited Moscow with the intention of pressing Russians to keep to the Yukos deal, Russian government withdrew its support for the Daqing route. Instead, Russia expressed interest in an even longer and more expensive pipeline from Taishet, and not Angarsk, to Nakhodka, from which oil could be shipped to Japan and other Asian customers. As a concession to China, Moscow suggested that a branch line could be built from the Nakhodka route down to Daqing, and Russia’s oil majors promised to double rail shipment of oil to China in 2005 to around 165,000 bpd, although that route was at full capacity and struggling to meet demand. Although unofficially “Beijing was very unhappy,” the Chinese government refrained from public criticism of Russian dithering, and meanwhile stepped up its interest in securing alternative supplies from Kazakhstan. Only on 31 December 2004, did Prime Minister Mikhail Fradkov formally announce the decision to go with Japan, although this was implicit from earlier events.

However, with Yukos out of the way, Moscow shifted its attention back to the Daqing route. In April 2005, Moscow repeatedly announced that the pipeline will head south from Skovorodino first, and that the Japanese fears that they would not be prioritised may be realised. A

405 Rutland, “Pipeline Pirouette in Northeast Asia.”
407 Rutland, “Pipeline Pirouette in Northeast Asia.”
409 Mihailescu, “U.S. Watches China’s Oil Demand, Deals.”
411 Uncertainties over the Daqing scheme and worries about the Middle East have made China all the keener to explore other options. Hence, a long-standing proposal for an oil pipeline from Central Asia to China, which had previously made little headway because of cost concerns, became an attractive option. On May 17, 2004, agreement was signed between President Nursultan Nazarbayev of Kazakhstan and Chinese President Hu Jintao on the construction of the Atasu-Alashankou oil pipeline. This pipeline now connects western Kazakhstan with China, as a part of very expensive - $3 billion - 1,200 km cross-border section of the pipeline from Atasu in Kazakhstan to Dushanzi in China’s Xinjiang region. This part of the pipeline, which took a couple of years to complete, and was opened in May 2006, will supply China with about 150,000 bpd in 2007. Once the pipeline is constructed all the way to Dushanzi, it is expected to supply China with up to 400,000 bpd. The pipeline links up with Kazakhstani pipelines connecting to the Caspian Sea region. John C. Daly, “Kazakhstan Inks Oil Pipeline Agreement with China,” Eurasia Daily Monitor, vol. 1, no. 13, May 19, 2004; and “Kazakhstan Oil Begins Flowing Into China,” Houston Chronicle, May 25, 2006. Further, on May 25, 2005, China and Uzbekistan signed an oil deal worth $600m. The joint venture between China National Petroleum Corp and Uzbekneftegaz lay at the heart of an agreement to establish a “friendly, co-operative partnership.” “The Dragon and the Tyrant,” The Economist.
412 Buszynski, “Oil and Territory in Putin’s Relations with China and Japan,” p. 291.
413 On April 6, 2005, Russian presidential adviser Viktor Ivanov said the government plans to construct a pipeline to transport oil to China from eastern Siberia. This was the first time that a key Russian official has clearly given China priority. “Russia to Build Branch of Oil Pipeline to China,” Alexander’s Gas & Oil Connections, vol. 10, no. 8, April 20, 2005. On April 19, Russia’s Industry and Energy Minister Viktor Khristenko told Japanese journalists that the Chinese branch would be constructed first. In addition, Igor Rogochov, Russian ambassador to Beijing, reiterated that the Chinese branch line would get first priority. Kanako Takahara and Mayumi Negishi, “Russian Minister Tight-lipped on Oil Pipeline Plans,” Japan Times, April 24, 2005; Kanako Takahara and Mayumi Negishi, “China to Get Oil Before Japan: Russian Envoy,” Japan Times, May 21, 2005.
mysterious $6 billion transfer from China for future oil deliveries that were used to help Rosneft buy Yuganskneftegaz in December 2004, may have influenced Moscow’s decision. When the government’s instructions to Transneft, the pipeline monopoly, were released in late April 2005, some of the details were missing. An oil port was supposed to be constructed at Perevoznaya (near Nakhodka), which was an odd choice, given the disruption it would cause to the habitat of a rare leopard. However, the schedule for pipeline construction, to be completed by the end of 2008, refers only to an initial section from Taishet, in eastern Siberia, to Skovorodino, in the Amur region, which is a ‘stone’s throw’ from the Chinese border. In support of prioritising China, in July 2005, Putin said that China would get two-thirds of 600,000 bpd of oil that Russia plans to export to Asia within four years. In September 2005, he said that Russia would first build a pipeline from eastern Siberia to China and then a smaller line to the Pacific coast near Japan. In early November 2005, Russian Prime Minister Mikhail Fradkov assured his Chinese counterpart Wen Jiabao that the construction of a key cross-border crude oil pipeline will go ahead as per 2001 agreement. Meanwhile, the Japanese counter-lobbied and argued that they would be content for the Chinese to get a spur from the main pipeline, but insisted that their branch be built first. They fear that without priority commitment to their route, the largely untapped east Siberian oil reserves will remain just that. In short, if their branch is not built first, it may never be built at all.

Hence, after Japanese pressure was applied, in a document on the pipeline project, which was the main focus of the Russo-Japanese summit in Tokyo in late November 2005 just weeks after Fradkov’s meeting with Wen Jiabao, Russia promised Japan that it will build a Pacific-bound oil pipeline linking eastern Siberia with the Russian Far East. However, Russia fell short of setting a date for constructing it, and some have suggested that despite public statements to the contrary, Russia is set to have the eastern Siberian pipeline serve China before Japan. As of December 2005, Russia started implementing a project to build the Taishet-Skovorodino pipeline, and Transneft and CNPC became engaged in talks to build a pipeline segment from Skovorodino to China, resulting in CNPC’s pledge to provide $400 million grant to finance a feasibility study and construction. On 22 March 2006, Putin said that this line would “ensure a dramatic increase in crude supplies from Russia to China.” Environmental concerns about prospecting near Lake Baikal, which is one of UNESCO’s World Heritage sites, were tackled by Putin, on whose initiative a decision was made to route the pipeline over 400 kilometers to the north of Lake Baikal. Finally, the construction of the Taishet-Skovorodino was launched in April 2006.

Outcome

415 “King Solomon’s Pipes,” The Economist, May 7, 2005, p. 60.
417 Ibid.
419 “King Solomon’s Pipes,” The Economist.
423 Ibid.
It is now certain that Russian Government’s state pipeline monopoly, Transneft, will be in charge of Far Eastern pipeline construction, as “the government intends to maintain control over Russian oil company exports.” According to analysts, Putin appears to have assured the Chinese that the question now is not if the pipeline will serve China, but whether it will serve China before Japan, and therefore, the decision who is going to be a primary customer, China or Japan, is still uncertain. As of early 2007, a 2,000 km pipeline from Taishet to Skovorodino is under construction, and is due for completion late in 2008. What happens after that has been at the centre of a diplomatic battle between Tokyo and Beijing in 2006 and 2007. The Russians are taking a “short-term tactical approach to an issue that both its potential partners view as strategic.” Therefore, it seems that oil-thirsty Asian countries, similar to ambitious IOCs, have little choice but to court the Kremlin. Japan has lobbied heavily for the next phase to consist of transporting crude another 2,000 km by rail, and eventually by pipeline, to a new export terminal off the Pacific coast in Perevoznaya Bay, although environmentalists would prefer it to be sited at the port of Nakhodka. The oil would then be shipped to Japan and other East Asian countries. Skovorodino, however, is only 70 km from the Chinese border, so Beijing has pressed for Russia to build a spur from that point to the Chinese border, where it would connect to a pipeline the Chinese would build from the ageing oilfields around Daqing, in Heilongjiang province. Below, I argue that China will most likely win this prolonged battle.

Analyses

Russia

Putin believes that Russian ownership of Russia’s resource base is critical to Russia’s economic recovery and to the country’s re-emergence as an important international actor. Russia’s natural resource base will not only secure the country’s economic development but will also serve as the guarantor of the country’s international position.

Russia is trying to use its role as a major oil and gas exporter as a means, or as a bargaining chip, in securing influence or pursuing its own goals in neighbouring countries. Russia’s position as an energy-exporting nation is a ‘power resource’ that enhances its status in foreign negotiations. Major economies, increasingly dependent on Russian gas and oil exports, are rendering themselves vulnerable to the ambitions of a country that has not refrained from using energy as a geopolitical weapon and has been ruthless in its treatment of both internal political opponents (oligarchs) and neighbouring states. In future, Russia will be well positioned to marshal its oil and gas reserves to support domestic and foreign policy objectives.

In early 2006, Russia flexed its political muscle when it turned off the gas to Ukraine, and therefore stopped subsidising the Ukrainian government, as Ukrainian political elite decided to go with the West and not to integrate in the post-Soviet space. Similar scenarios followed suit with Belarus and Moldova in March 2006, with Georgia later that year, and Poland and Germany in January 2007. Russian government officials have talked tough with West European leaders,

426 Boussena and Locatelli, “Towards a more Coherent Oil Policy in Russia?” p. 96.
427 “China Unfulfilled.”
428 “King Solomon’s Pipes,” The Economist.
432 For example, some have suggested competition between Europe and China for Russian gas. See Roland Götz, “Europe and China Competing for Russian Gas?” German Institute for International and Security Affairs, SWP Comments, no. 14, May 2006.
433 In January 2006, Russia stopped exporting gas to Ukraine, after Ukraine refused to accept a massive price hike from $50 to $230 for 1,000 cubic meters. Moldova was cut off after refusing to accept a price doubling, to $160 per
raising the prospect that they might divert energy supplies to China and the U.S. if the
Europeans do not meet their demands for better market access, including ownership of some
refining and distribution operations. As investigated in this case study, Russia is playing the
energy card in a similar way in its Far East with Japan and China, where it is deliberately using its
indecisiveness about the priority choice of pipeline route to secure influence in its relationship
with Japan and China. Putin is aware of the fact that both Japan and China need oil and that
considering current market conditions they would offer a lot for priority rights to Russian oil.
This is similar to Russia’s exports of gas. If Russia does not accept gas offers from Ukraine or
Western European governments, it can choose to accept those from China, Japan or India, and
this choice gives it bargaining advantage against its customers.

The bottom line is that senior Russian leaders believe that their country can ultimately punch far
above its weight internationally by systematically increasing both its allies’ and its adversaries’
dependence on Russian energy supplies and distribution networks. After all, in 2006 Russia
was presiding the Group of Eight (G8), a forum for rich democracies, despite being neither rich
nor democracy. Western and Asian states, including all current and future great powers, are
rendering themselves increasingly, and in many cases dangerously, dependent on Russian energy.
As Russia’s neighbours have already learned, such dependence comes at a price.

The official Russian position in negotiations regarding the Far East pipeline construction reflects
the importance of issue linkage. From a strategic security standpoint, the growing energy
requirements of a rapidly modernising China and the desire of other Asian economies (i.e. Japan)
to diversify their sources of supply create opportunities for Russia to become an important
strategic player in the Asia-Pacific region. However, in becoming a strategic player in the
region, in building a major branch of its Far Eastern oil pipeline, Russia has to choose between
China and Japan. Why should Russia choose one over the other?

General Sino-Russian relations seem to be much better than during the Soviet times. Moreover, they are also perceived as ‘friendly’ by majority of the Russian public. Close Sino-
Russian relations are evident in large-scale Russian arms sales to China, leading the latter to
become the largest recipient of Russia’s arms receiving more than a quarter of its total arms
deliveries, with average annual purchases of well over $1 billion. Besides arms sales, Russia is


434 “Crude Power,” p. 23.
439 In a survey conducted by Russian Department of State, Office of Research, between January 29 and February 11, 2000, Russia’s relations with China were considered friendly by 52% of respondents, while only 9% considered Sino-Russian relations as difficult. Meanwhile, while 20% considered Russo-American relations as friendly, 48% percent considered them difficult. Department of State, Office of Research, “Opinion Analysis,” March 14, 2000, p. 4.
also the largest nuclear technology supplier to China, thus helping China to quadruple its nuclear power capacity by 2020. Close Sino-Russian relations are also evident in the final resolution of long-standing border issues in 2004; in unprecedented level of cooperation, as in 2005 presidents Vladimir Putin and Hu Jintao met four times and issued a joint declaration on the 21st century world order; in the fact that in 2005, the two countries carried out their first joint military exercises on Chinese soil and in the East China Sea involving around 10,000 troops; and in the fact that their bilateral trade in 2005 increased by more than 30 percent to $29-30 billion. One could therefore argue that Sino-Russian new ‘strategic partnership’ or ‘axis of oil’ is a sign of collaboration in order to balance the hegemon – the United States – and supports the realist assumption that in unipolar world, hegemonic challengers tend to get in some sort of formal or informal alliance to counterbalance the overwhelming power of the hegemon.

Russia’s earlier security and other collaboration with the United States, in which it unilaterally offered numerous concessions to the Americans, pointed towards Russian bandwagoning, rather than balancing the hegemon. However, this has changed in recent years, and following negative developments in the U.S.-Russian relationship, the U.S. Council on Foreign Relations (CFR) concluded that Russia was “headed in the wrong direction.”445 Besides other bilateral developments with China, mentioned in the previous paragraph and in this case study, since 2003 Moscow has worked assiduously to establish a new sphere of influence in Central Asia and Former Soviet Union in general, using regional autocrats’ interest in resisting U.S. pressure to democratise. Meanwhile, China has been trying to avoid ‘encirclement’ by U.S. forces and limiting its reliance on maritime supplies, to maximise pressure on America. Therefore, Russia and China have found a common cause in limiting U.S. influence in Central Asia, and their 2001 establishment of Shanghai Cooperation Organization (SCO) together with three (now four) Central Asian states may serve to achieve that goal. In addition, together with Beijing, and against Washington, Moscow has been opposed to the 1999 NATO’s Kosovo campaign, the 2003 U.S.-led invasion of Iraq, and to any comprehensive sanctions or other cause of action to be carried out against Tehran for its alleged non-compliance with the Nuclear Non-proliferation Treaty (NPT). It is also important to keep in mind that Iran has been an SCO observer, with the possibility of joining the organisation in future. Western analysts are increasingly alarmed that

443 Putin has consistently pursued a policy of cooperation with the United States, without pressure from domestic constituencies, making a stream of hitherto unimaginable concessions by allowing the U.S. to - extend NATO to include the Baltics, station its troops in Central Asia to wage war in Afghanistan, unilaterally withdraw from the Anti-Ballistic Missile Defense (ABM) Treaty, and to have special forces in Georgia. For details, see Dale Herspring and Peter Rutland, “Foreign Policy Under Putin,” in Dale Herspring and Jacob Kipp (eds.), Putin’s Russia (Rowman and Littlefield, 2002), ch. 11. Further, the 800,000 - 1 million bpd, 1,767 km Baku-Tbilisi-Ceyhan (Azerbaijan-Georgia-Turkey) pipeline, which is the lynchpin of U.S. policy towards the Central Asia, was explicitly designed so as to provide an alternative export route for Caspian oil that did not involve transiting Russia. Peter Rutland, “Russia’s Response to U.S. Regional Influence,” National Bureau of Asian Research Journal Analysis, vol. 14, no. 4 (November 2003), p. 5. See also “Oil Over Trouble Waters,” The Economist, May 26, 2005.
444 Rutland, “Russia’s Response to U.S. Regional Influence.”
446 Leverett and Noel, “The New Axis of Oil,” p. 65. Also see Dmitri Trenin, “Russia Leaves the West,” Foreign Affairs, vol. 85, no. 4, July/August 2006, pp. 87-96.
448 For more on SCO and Iranian role there, see Douglas, Nelson and Schwartz, “Fueling the Dragon’s Flame,” pp. 10-14.
the economic and political endgame of the SCO is to limit the U.S. influence in Central Asia. In addition to opposing U.S. interventionism, and its influence in Central Asia, Moscow and Beijing held common views in opposing both Washington’s alliance systems and its plans for national missile defence. Finally, both countries resent foreign criticism of their domestic human rights records, and outside meddling in what they see as illegitimate separatism in Chechyna and Taiwan. Clearly, Russia and China share an interest in ensuring a multipolar world as opposed to a unipolar world dominated by the United States. Developing further energy links would certainly help cement these growing ties.

Building a pipeline towards Japan or China would most probably bring in additional 0.6 – 1.6 million bpd of export capacity and it would play an important role in increasing Russian oil export volumes and revenues, which are needed in order to maintain Russia’s steady economic growth. If there were sufficient amounts of oil reserves in Eastern Siberia, Japan would be a better option when considering future export volumes. However, most likely, there are insufficient oil reserves to justify the at least 1 million bpd Nakhodka pipeline, particularly given uncertainties about extraction costs in the new and geologically difficult fields of East Siberia. Thus, it is also highly unlikely that Eastern Siberia contains sufficient oil reserves to satisfy the needs of both Japan and China. Eastern Siberia and Russia’s Far East have a small share of the country’s total reserves – 7 percent, compared with 72 percent in Western Siberia. In addition, Edward Chow argues that “everyone, even the [Russian] government, agrees there are not enough resources in the eastern half of Russia to commercially guarantee throughput for the line to Nakhodka,” and many other analysts concur with this prediction. Indicative of this was Putin’s statement from July 2006, when he said that he could not give Japan guarantees that a planned Far Eastern pipeline would eventually reach the Pacific coast, citing uncertainty about oil supplies.

Naturally, if there was enough oil in Russia’s Far East and East Siberia, the ‘Japan’ route would give Russia access to more markets rather than just Chinese market if it chooses the ‘China’ route and Russia could therefore have a large number of potential customers. Some have argued that the Nakhodka project would not lock Russia into a single buyer, China. Hence, the Pacific destination of the pipeline would possess self-evident marketing advantages over the Chinese route. In such scenario, Russia’s international bargaining position would be strengthened. However, Russia should prioritise the ‘China’ route in order to make China more dependent on Russian oil, and therefore gain more bargaining power vis-à-vis China per se. While it has been suggested that exporting to China and not any other market in East Asia would be dangerous for Russia, as it would rely just on one market, this assumption is incorrect. Russia has plenty of

453 Quoted in “Russian Oil Pipeline Takes a Tentative Step Forward.”
456 See, for example, Buszynski, “Oil and Territory in Putin’s Relations with China and Japan.”
457 Ibid.
other markets in the west – Western and Eastern Europe, the United States – which would certainly welcome more Russian oil, in case China decides to stop purchasing it. Russia has a complex system of pipelines stretching from Western Siberia to Europe, and it would not be a large obstacle for Russia to link Western and Eastern Siberian pipelines. It would be unwise not to do so. Hence, a common perception that in case the Far Eastern pipeline is not built to the Pacific, Russia would be relying solely on Chinese market is false. Moreover, China and Russia had reached a mutually acceptable agreement on pricing as part of the deal, and this further supports my argument that Russia should prioritise the China route.

Furthermore, Russia’s security objectives could be put in danger if it prioritises the ‘Japan’ route, as this could cause serious deterioration in Sino-Russian relations and it may trigger Chinese assertiveness in its pretensions against the Russian Far East, which was once a part of China. If Russia dropped the China pipeline, its Far East would transform from a region of economic potential to a source of strategic vulnerability. According to some sources, Beijing poses a threat to Russia, and “this is especially true in Siberia and the Far East region, where economic development is lagging and population decreasing.” There is concern amongst Russians that Chinese immigration and settlement in Russia’s Far East would naturally follow. According to Mikhail Khodorkovsky, “a rapid Sinification of the Asian part of Russia is already taking place, and represents the main strategic threat to the country’s security.” This attitude contrasts the general Sino-Russian relations, which, as shown above, seem to be much better than compared to the Soviet times. This issue is an important one for Russia, as it is axiomatic in Russian conceptions of security to assert the primacy of defending the nation’s ‘territorial integrity.’

Russia’s territorial integrity is at stake in its relations with Japan too. However, unlike in Moscow’s relationship with Beijing, they are a dominating factor in its relationship with Tokyo. If Russia decides to build the pipeline to prioritise it, Japan, unlike China, would not put aside the Kuril Islands issue, which has been on Japan’s agenda ever since the end of the World War II, and which has consistently been the major obstacle in its relations with Russia. The Russian government may be in for a rude awakening, since the Japanese government might raise the

458 Viktor Kalashnikov, an economist from Khabarovsk, cited in Rutland, “Pipeline Pirouette in Northeast Asia.”

459 These territories (Khabarovsk, Primorye, Amur, Birobidzhans regions) were acquired controversially through ‘unequal’ treaties, such as the 1860 Treaty of Peking. Lo, Vladimir Putin and the Evolution of Russian Foreign Policy, p. 91.

460 See Brown, “Looking to the East,” pp. 28-9: “the siloviki are against providing energy to China for fear of building up an already formidable rival;” and Yergin, “Over a Barrel”: “the wrangle over a proposed pipeline for Siberian oil to Asia is not just a commercial matter – it reflects all the rivalries and suspicions among China, Russia, and Japan.”


463 Lo, Vladimir Putin and the Evolution of Russian Foreign Policy, p. 90.
return of the ‘Northern Territories’ (the southernmost Kuril Islands) as a precondition for concluding the deal. Moscow assumes that Tokyo has given up on getting the islands back, but that is erroneous.\(^ {463}\) The two countries have not signed a peace treaty formally ending hostilities of World War II, and longstanding territorial issues are far from solved.\(^ {464}\) Alternatively, if Russia prioritises the ‘China’ route, Japan could decide to push the Kuril Islands issue up to the top of its foreign policy agenda, and we would witness further deterioration of Russo-Japanese relations. However, Russia does not share a land border with Japan, and Japan is far from a military and demographic threat to Russia’s Far East. Therefore, Russia needs not fear any threat to its territorial integrity from Japan.

On one hand, if Russia decides against China’s priority route, Beijing will continue to establish its presence in Central Asia in order to get that extra 0.6 million bpd it would not get from Russia. In addition, China’s structural power in the Far East clearly points towards a large power asymmetry, as “China has a superior position to Russia in the region both politically and economically.”\(^ {465}\) Hence, as already stated, Russia’s strategic security objectives could be in danger as power asymmetry increases. In such situation, we could witness Chinese assertiveness against Russia’s Far East, and hence “alienating Beijing is simply not an option for Moscow.”\(^ {466}\) On the other hand, if Russia chooses the ‘China’ route, this would most likely mean that China would not actively pursue its ambitions against Russian Far East in the short or the long run. As the bilateral relationship between Russia and China would be further improved, this would be a further sign of the two countries’ attempt to balance the hegemon. Goldstein and Kozyrev have argued, “The formation of the Sino-Russian energy nexus would represent a strong consolidation of an emergent bipolar structure in East Asia, with one pole led by China (and including Russia) and one led by the United States (and including Japan).”\(^ {467}\)

While domestic factors affect Russia’s official position in pipeline bargaining with China and Japan, they fail to influence Russia’s final decision. Was it not for 2003 crackdown on Yukos, and the prevalence of siloviki in the Kremlin, the private pipeline to Daqing would have already been under construction. However, influenced by the international power objectives Putin resumed state control over the country’s oil industry and decided to go against Yukos’ original plan, with the plan supported by the siloviki, the ‘Japan’ route. For a while, Putin played to siloviki wishes but has since changed his decision likely to settle with the ‘China’ route.\(^ {468}\) Domestic factors did not influence Putin’s, and therefore Russia’s, final decision, since Putin centralised decision making in Moscow, demonstrated his own personal management of foreign policy, and reduced the role of domestic actors.\(^ {469}\)

It can be argued that one of the reasons behind Russia’s potentially final decision could lie in its receipt of multi-billion dollar transfers from China and Japan. Both China and Japan are willing to offer considerable amounts of money to gain Russia’s preference. Elsewhere, in what clearly portrays its financial superiority vis-à-vis Japan, China has been outbidding other competitors in

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\(^ {463}\) Japanese political scientist Hiroshi Kimura, cited in ibid.


\(^ {465}\) Harada, Russia and North-east Asia, p. 46.

\(^ {466}\) Goldstein and Kozyrev, “China, Japan and the Scramble for Siberia,” p. 175.


\(^ {468}\) The role of siloviki in Russian politics has been more modest than commonly asserted. See Bettina Renz, “Putin’s Militocracy? An Alternative Interpretation of Siloviki in Contemporary Russian Politics,” Europe-Asia Studies, vol. 58, no. 6, September 2006, pp. 903-24; and Edwin Bacon and Bettina Renz, Securitizing Russia: The Domestic Politics of Putin (Manchester: Manchester University Press, 2006).

\(^ {469}\) Buszynski, “Oil and Territory in Putin’s Relations with China and Japan,” p. 287.
the energy field by sometimes offering even “twice as much as its closest competitors” ever since its emergence as a net oil importer in 1993.471 $6 billion provided by China in December 2004 for future oil deliveries, that were used to help Rosneft, a state-owned oil company, buy Yuganskneftegaz, may have influenced Moscow’s decision, as Putin used this money to consolidate government’s control over the oil industry in Russia, as this is a crucial element in enabling Russia to rise to its historical power status. Government-controlled oil pipelines permit the government to control supply and direct investment flows not only into the pipeline sector, but also in the economy as a whole. It also maintains a system of differential pricing and preferential access to resources, allowing the government to hand out rewards and punishments for both economic and political reasons.472 In addition, state control of the oil industry adds considerable bargaining power in Russia’s foreign policy, as compared to the situation in which the pipelines were owned and operated by private owners. However, although this money was important for Putin, China’s $6 billion transfer did not influence Russia’s final decision, since in the same month (December 2004) Prime Minister Mikhail Fradkov formally announced Russia’s decision to go with Japan.

Unsurprisingly, Russia’s international position is strengthened by its indecisiveness over the primary route of Far Eastern oil pipeline. Continuous interest shown by China and Japan gives Russia the sense of importance in the international affairs. Friendly relations with China would be more important to Russia than increased bargaining power against Japan or any other oil importer. Due to its rapid growth, China is increasingly seen as a strategic security threat against Russia’s Far East, and prioritising the ‘China’ route would reduce this threat and bring Russia and China even closer together in attempting to balance American hegemony. Although if Russia prioritises the ‘Japan’ route, it would get a wider export market, and therefore more bargaining power against a variety of East and Southeast Asian actors, Russia has access to many markets in its west, so reliance solely on China in the Far East would not leave it hostage to China’s oil purchases. It could play a strategic ‘game’ with China by threatening to divert its exports westwards. Although the Pacific route would enable Russia to export more oil and therefore possibly receive more revenues, it is highly likely that East Siberia cannot reach a production capacity of 1 million bpd, what is the minimum required to feed this pipeline.

**China and Japan**

China’s foreign policy is almost completely dominated by energy concerns, as it is trying hard to gain control of any overseas oil at the source, and it is attempting to diversify its sources of imported energy.473 Hence, to an extent, China’s strategic security concerns explain the most likely outcome of pipeline bargaining between Russia, China and Japan. Since it became a net oil importer in 1993, China violated the Maoist doctrine of self-reliance.474 For example, in 2005, China imported 48 percent of the crude oil it consumed (see Table 3.5). Applied to the energy sector, self-reliance implies the ultimate control by the government over the domestic energy sector.475 In order to achieve long-term security ‘independence’, China seeks to reduce its short-term energy dependence and vulnerability away from cooperation with the United States. The U.S. controls the sea routes leading from the Persian Gulf to the East Asian ports, particularly the Strait of Hormuz and the Malacca Straits. Therefore, the U.S. is seen by some Chinese

472 Chow, “Russian Pipelines,” p. 32.
474 From a theoretical perspective, reliance on imported oil arguably violates the Maoist doctrine of self-reliance (zili gengsheng), the guiding principle for economic development in the 1960s and 1970s. Strecker Downs, *China’s Quest for Energy Security*, p. 11
analysts as the major threat to China’s energy security.\(^{476}\) Diversification of import sources, to Central Asia and Russia among others, is therefore, the main objective of Chinese energy policy, evident in its effort to construct a “pan-Asian continental oil bridge.”\(^{477}\) Diversification is a sound strategy for energy security that both the United States and Japan have pursued.\(^{478}\)

Table 3.5: China’s Crude Oil Production and Consumption (1992-2005)

<table>
<thead>
<tr>
<th>Year</th>
<th>Production (mbpd)</th>
<th>Consumption (mbpd)</th>
<th>Balance (mbpd)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1992</td>
<td>2.841</td>
<td>2.740</td>
<td>0.101</td>
</tr>
<tr>
<td>1993</td>
<td>2.888</td>
<td>3.051</td>
<td>-0.163</td>
</tr>
<tr>
<td>1994</td>
<td>2.930</td>
<td>3.116</td>
<td>-0.186</td>
</tr>
<tr>
<td>1995</td>
<td>2.989</td>
<td>3.395</td>
<td>-0.406</td>
</tr>
<tr>
<td>1996</td>
<td>3.170</td>
<td>3.702</td>
<td>-0.532</td>
</tr>
<tr>
<td>1997</td>
<td>3.211</td>
<td>4.179</td>
<td>-0.968</td>
</tr>
<tr>
<td>1998</td>
<td>3.212</td>
<td>4.228</td>
<td>-1.016</td>
</tr>
<tr>
<td>1999</td>
<td>3.213</td>
<td>4.477</td>
<td>-1.264</td>
</tr>
<tr>
<td>2000</td>
<td>3.252</td>
<td>4.772</td>
<td>-1.520</td>
</tr>
<tr>
<td>2001</td>
<td>3.306</td>
<td>4.872</td>
<td>-1.566</td>
</tr>
<tr>
<td>2002</td>
<td>3.346</td>
<td>5.288</td>
<td>-1.942</td>
</tr>
<tr>
<td>2003</td>
<td>3.401</td>
<td>5.803</td>
<td>-2.402</td>
</tr>
<tr>
<td>2005</td>
<td>3.627</td>
<td>6.988</td>
<td>-3.361</td>
</tr>
</tbody>
</table>

Source: BP Statistical Review of World Energy 2006

In accordance with its strategic security goals, China is ready to pay any price to secure that Russia prioritises the Daqing route. China’s oil imports from Russia amounted to barely 80,000 bpd in 2004, rising to 320,000 bpd in 2006,\(^{479}\) and if pipeline were built, this could be raised to at least 600,000 bpd. China depends on the U.S. for security of sea-lanes between the Middle East and East Asia, and is vulnerable to embargoes or blockades of Middle Eastern oil supplies. Thus, higher reliance on Russian oil would result in lower demand for oil from the Middle East, which is a region that supplied China with 40.2 percent of its crude oil imports in 2005 (see Table 3.6).

Table 3.6: Chinese, Japanese and American Oil Imports by Region of Origin (2005)

<table>
<thead>
<tr>
<th>Region</th>
<th>China (kbpd)</th>
<th>Of total</th>
<th>Japan (kbpd)</th>
<th>Of total</th>
<th>United States (kbpd)</th>
<th>Of total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Unidentified</td>
<td>6</td>
<td>0.2%</td>
<td>44</td>
<td>0.8%</td>
<td>214</td>
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</tr>
<tr>
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<td>6</td>
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</tr>
<tr>
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<td>47</td>
<td>0.9%</td>
<td>473</td>
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</tr>
<tr>
<td>Middle East</td>
<td>1360</td>
<td>40.2%</td>
<td>4269</td>
<td>81.7%</td>
<td>2345</td>
<td>17.3%</td>
</tr>
<tr>
<td>N. Africa</td>
<td>64</td>
<td>1.9%</td>
<td>2</td>
<td>0.0%</td>
<td>547</td>
<td>4.0%</td>
</tr>
<tr>
<td>W. Africa</td>
<td>574</td>
<td>17.0%</td>
<td>60</td>
<td>1.1%</td>
<td>1943</td>
<td>14.4%</td>
</tr>
<tr>
<td>E. and S. Africa</td>
<td>135</td>
<td>4.0%</td>
<td>80</td>
<td>1.5%</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>S. and C. America</td>
<td>107</td>
<td>3.2%</td>
<td>2</td>
<td>0.0%</td>
<td>2868</td>
<td>21.2%</td>
</tr>
</tbody>
</table>


\(^{477}\) “Experts Call for a Pan-Asian Oil Bridge,” Xinhua, June 16, 1996. In order to accomplish this goal, China has already established energy ties with Iran, Kazakhstan, Turkmenistan and Uzbekistan.

\(^{478}\) Strecker Downs, China’s Quest for Energy Security, p. 19. One (the U.S.) more successfully than the other (Japan).

There has been some opposition to increasing energy cooperation with Russia on national security grounds coming from Chinese domestic actors. A number of China’s leaders and People’s Liberation Army (PLA) officers are reportedly opposed to increasing energy cooperation with Russia, as they are concerned that in the event of a Sino-Russian crisis, Russia would stop the flow of energy resources to China. However, despite these worries, the overall security objectives still favour the construction of a pipeline from Russia amidst the potential future risk, which unavoidably also exists in other projects.

Domestic factors are crucial in determining Chinese policy choice. Beijing’s external affairs are closely intertwined with its domestic policy, and the watchword that drives both is stability. Beijing seeks continued economic growth, because rising living standards provide the party’s only claim to legitimacy: “Economic growth has become the central justification for continued CCP rule since Mao’s death … it determines the future of the entire political system.” Moreover, since rapid economic growth is crucial for maintaining the domestic regime stability, domestic interests are more important than foreign policy interests. For example, Ng argues that “holding on to state power has been and continues to be the main objective of the CCP.” In recent years, according to Xu Yi-Chong, “continuing economic growth has been threatened by the shortage of energy supplies,” and this issue has thus drawn much political attention in Beijing, especially since “energy shortages in China can choke its economy and lead to a serious economic slowdown.” In order to continue fuelling its economic growth, it is paramount for China to secure access to increasing amounts of imported oil every year. Thus, in future, bringing more Russian oil to China will be crucial for satisfying its mounting energy demand. Moreover, the pipeline to Daqing would serve one of China’s national development goals – “Revitalising the Northeast” – because, if built, it could provide jobs for this economically suffering region, China’s ‘rust belt’ of sunset manufacturing enterprises.

Japan is currently the second largest importer and the third largest consumer of crude oil in the world. Its ambition to get Russian oil via the construction of a pipeline which would primarily serve Japan’s oil needs, reflects its efforts to diversify the sources of imported oil, as “Japanese officials claim that diversification of supplies is paramount for the future of the Japanese economy.” It is commonly argued, “Energy development in the Russian Far East can be

<table>
<thead>
<tr>
<th></th>
<th>N. America</th>
<th></th>
<th></th>
<th>Australasia</th>
<th></th>
<th></th>
<th></th>
<th>Other Asia Pacific</th>
<th></th>
<th></th>
<th>Total</th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>8</td>
<td>0.2%</td>
<td>90</td>
<td>1.7%</td>
<td>3819</td>
<td>28.2%</td>
<td>1.7%</td>
<td>65</td>
<td>0.7%</td>
<td>511</td>
<td>9.8%</td>
<td>202</td>
<td>0.1%</td>
<td>1.7%</td>
</tr>
<tr>
<td></td>
<td>25</td>
<td>0.7%</td>
<td>65</td>
<td>1.2%</td>
<td>14</td>
<td>0.1%</td>
<td>1.7%</td>
<td>65</td>
<td>9.8%</td>
<td>511</td>
<td>9.8%</td>
<td>202</td>
<td>0.1%</td>
<td>1.7%</td>
</tr>
<tr>
<td></td>
<td>626</td>
<td>18.5%</td>
<td>511</td>
<td>9.8%</td>
<td>14</td>
<td>0.1%</td>
<td>1.7%</td>
<td>65</td>
<td>9.8%</td>
<td>511</td>
<td>9.8%</td>
<td>202</td>
<td>0.1%</td>
<td>1.7%</td>
</tr>
<tr>
<td></td>
<td>3384</td>
<td>100.0%</td>
<td>5225</td>
<td>100.0%</td>
<td>13525</td>
<td>100.0%</td>
<td>100.0%</td>
<td>13525</td>
<td>100.0%</td>
<td>13525</td>
<td>100.0%</td>
<td>13525</td>
<td>100.0%</td>
<td></td>
</tr>
</tbody>
</table>

Source: BP Statistical Review of World Energy 2006
instrumental in helping diversify energy supplies and thus enhance energy security. However, as it is a strategic ally of the United States, it does not feel as vulnerable in having to rely on the U.S. for protection of supply lines from the Middle East, where most of its oil comes from. Moreover, as it relies on the U.S. for protection, although it has been a net oil importer for decades, unlike China and the U.S., it completely failed to pursue its diversification policy, since its imports from the Middle East in 2005 constituted 81.7 percent of total oil imports (see Table 3.6). Thus, since the U.S. is its major ally, the strategic motivation behind Japan’s diversification policy is far less pronounced than in the case of China.

In addition, the importance of securing extra crude oil for imports is less important for Japan than for China, since Japan’s crude oil consumption has been on a downward slope since its peak in 1996, and has dropped by 8 percent between then and 2005 (see Table 3.7). Unlike China, where oil consumption almost doubled, and oil imports grew six-fold in the same period (see Table 3.5), Japan is becoming less reliant on imported oil and price volatility and political instabilities associated with it, because it is investing large sums of money in alternative sources of energy and is promoting energy conservation. Hence, Russia’s Far East, which is also rich in natural gas, could “contribute to Japan’s efforts of diversifying its sources away from oil to natural gas.” Further, investing, for example, $5 billion into Nakhodka pipeline would add about $2 per barrel to every imported barrel Japan consumes for the next 40 years. Put another way, if it does not invest $5 billion in Nakhodka, Japan could afford to pay a $2 per barrel premium for every barrel to give it a competitive edge against every other oil consumer on the market, and still come out even. Hence, Japanese strategic security factors are less pronounced than those of China in determining the possible outcome of pipeline bargaining between the two countries and Russia.

Table 3.7: Japan’s Crude Oil Consumption (1996 – 2005)

<table>
<thead>
<tr>
<th>Year</th>
<th>Consumption (mbpd)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1996</td>
<td>5.813</td>
</tr>
<tr>
<td>1997</td>
<td>5.762</td>
</tr>
<tr>
<td>1998</td>
<td>5.525</td>
</tr>
<tr>
<td>1999</td>
<td>5.618</td>
</tr>
<tr>
<td>2000</td>
<td>5.577</td>
</tr>
<tr>
<td>2001</td>
<td>5.435</td>
</tr>
<tr>
<td>2002</td>
<td>5.359</td>
</tr>
<tr>
<td>2003</td>
<td>5.455</td>
</tr>
<tr>
<td>2004</td>
<td>5.286</td>
</tr>
<tr>
<td>2005</td>
<td>5.360</td>
</tr>
</tbody>
</table>

Source: *BP Statistical Review of World Energy 2006*

In contrast to Sino-Russian relations, Russo-Japanese relations have undergone no significant improvement since the collapse of the Soviet Union, and this is despite the October 1993 Tokyo Declaration, which promised some improvements in the relations between the two countries. The territorial dispute over the four islands between the Sea of Okhotsk and the North Pacific remains a persistent source of tension between the two countries, which negatively affects the

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488 For interesting insight into this issue, see Roberts, *The End of Oil*, pp. 188-212.
491 Harada, *Russia and North-east Asia*, p. 49. For the geopolitical and historical context of Russo-Japanese relations see Takamichi, “Japan’s Energy Strategy,” pp. 3-5.
possibility of Russia prioritising the ‘Japan’ pipeline. Japan’s long-standing approach to the territorial dispute had been to adopt the “principle of inseparability of political and economic relations” (seikei fukabun). Hence, without progress on the territorial issue, which will remain a major cause of tension between Russia and Japan, there can be no progress in other areas.\(^492\) The persistent ‘Northern Territories’ question continues to be the foundation of Japan’s Russia policy and therefore continues to cast a deadly shadow on bilateral relations.\(^493\) As an illustration, after the Russo-Japanese summit in Tokyo in November 2005, Japanese Prime Minister Koizumi said, “We [Japan] recognised the need to resolve the island ownership issue and conclude a peace treaty. But frankly speaking, there are considerable gaps between the two countries.”\(^494\) This became particularly evident when in late 2005 Moscow backed away from positions favouring a limited territorial deal with Japan that it had maintained for more than a decade.\(^495\)

**Conclusion**

Regardless whether the pipeline route prioritises China or Japan, Russia will improve its international standing by directly controlling new oil export pipelines through Transneft. If it prioritises the ‘China’ route, it will improve the strategic security situation in its Far East by reducing China’s threat potential against territorial integrity of its demographically weak regions. In opposition to what many have argued, Russia would actually increase its bargaining power over China, what is much more important an objective than increased bargaining power against Japan, as it could threaten China with diverting its oil exports to Europe or the United States. China seeks access to Russian oil for its own strategic security reasons – energy security by meeting rising oil imports and by oil import diversification – and domestic reasons – sufficient energy supply to keep the economic growth at high levels – all in order to maintain regime stability. Due to domestic pressure, Japan seems unwilling to improve its economic or political relationship with Russia until the issue of Kuril Islands is resolved. While the overall factors point to Russia prioritising the ‘China’ route (see Table 3.8),\(^496\) as of early 2007 this issue is not resolved. However, according to memoranda signed during President Putin’s visit to China in March 2006, over the next 15 years Russia will most likely become the largest energy supplier to China.\(^497\) This will only be possible if numerous oil and natural gas pipelines link the two countries.

<table>
<thead>
<tr>
<th>Table 3.8: Factors Favouring “China” and “Japan” Pipeline Route</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Factor</strong></td>
</tr>
<tr>
<td>---------------------------------</td>
</tr>
<tr>
<td>Overall relationship with Russia</td>
</tr>
</tbody>
</table>


\(^496\) Previously, I already argued that China was likely to succeed in Russia’s Far Eastern pipeline bargaining. See Vlado Vivoda, “Russia and China: A Bear Hug for a Dragon,” *Transitions Online*, July 18, 2005, [www.tol.cz](http://www.tol.cz) [July 19, 2005]. In a separate account, Gabe Collins also suggested that China is likely to succeed, see “Fueling the Dragon: China-bound Pipelines are Russia’s Most Realistic Asian Energy Options,” *Geopolitics of Energy*, vol. 28, no. 9, 2006, pp. 12-20.

\(^497\) Simonia, “Russian East Siberia and the Far East,” p. 73.
| Route’s revenue potential                  | +   |
| Market access                             | +   |
| Strategic importance for China/Japan      | +   |
| Domestic opposition in China/Japan        | +   |
| Route’s feasibility                       | +   |
| Route’s cost                              | +   |
| Route’s construction time                 | +   |
| Financial capability of China/Japan       | +   |
| China/Japan as a strategic threat to Russia if not prioritised | +   |
| Overall in favour                         | 8   | 2   |

**Relationship with Hypotheses**

This case study has direct relevance to two hypotheses set in Chapter 2. Evidence presented is partially supportive of hypothesis four, which states that if a major oil-importing government’s oil supply security is perceived as threatened when bargaining with other actors, then this government will emerge victorious from bargaining. Based on the evidence presented above, while this certainly seems to be the case in China, it does not apply for Japan. In addition, this case study also appears partially supportive of hypothesis five, as Russia uses oil (or construction of an oil pipeline), both explicitly and tacitly, in bargaining with China and Japan, and by doing so, it gains concessions from China (funds; no pretensions against Russia’s Far East), but not from Japan (the Kuril Islands are not put aside). For discussion of these findings, please refer to Chapter 7.
VENEZUELA

The focus of this chapter is on contemporary bargaining in Venezuela’s oil industry, involving President Hugo Chávez, IOCs, the U.S. government, China, and various NOCs as the main actors. The main determinants of the outcome of oil industry bargaining in Venezuela are of political nature, as politics trumps economics when it comes to Venezuela’s oil policy. Economics do however play a limited role in determining the outcome of oil industry bargaining in Venezuela, as high oil prices provide Chávez with much needed petro-dollars. Regardless, cheap energy that Chávez provides to much of Latin America defies any economic logic, and so does China’s attempt to secure equity deals in Venezuela. Chávez’s reform, or re-nationalisation, of the oil industry was carried due to his attempt to secure the regime stability, and in relation, to support his Bolivarian Revolution, success of which is fundamental for regime survival. An increased share of oil income at the expense of IOCs allows Chávez to pay social benefits, reward friends, punish enemies, buy elections and maintain power without seeking the sort of political legitimacy a broad tax base usually demands in a diversified economy.

Introduction to Venezuela’s Oil Industry

Venezuela’s oil industry history can be roughly divided into six major periods: the discovery and initial production of oil (1878-1920s); foreign oil companies’ domination (1920s-1945); government’s assertion of control (1945-1974); the oil boom and nationalisation (1974-1990); loosening of government control over PdVSA in 1990, followed by launch of the policy of la apertura (opening) in 1993, which was an open invitation to foreign investment (1990-1999); and finally government’s resumed control over an increasingly independent oil industry (1999-present). Although the history of Venezuela’s oil industry is fascinating, much of it is beyond the scope of this study, and below, only recent history is briefly examined.498

In 1975, and as a part of the ‘La Gran Venezuela’ plan, in what President Carlos Andrés Pérez called “an act of faith,” Venezuela nationalised its oil industry creating Petróleos de Venezuela S.A. (PDVSA), the country’s state-run oil and natural gas firm and Latin America’s largest company. Control over PDVSA has been in dispute ever since, and critics of the nationalisation process, such as Carlos Mendoza, argue that the newly nationalised oil industry was nothing more than a Trojan horse used by western oil companies. This was particularly the case from 1990 when Andre Sosa Pietri was appointed chairman of PDVSA. Sosa Pietri began questioning both the government control of the company and its association with OPEC. He wanted a free hand in running PDVSA, which he hoped to open to various forms of interaction with foreign companies and capital. He did not want to be subjected to OPEC, which he dismissed as “only a myth,” a relic of the past that, were it to survive, would be transformed into nothing more than a “research centre.” Taking advantage of a corrupt political system paralysed by the impending impeachment proceedings against President Pérez, Sosa Pietri led PDVSA to become independent source of power that could bend the will of Congress to its own aims. Thus, it was not a major effort for him to obtain green light for making deals with foreign companies, and he drove the steady growth of Venezuelan oil production irrespective of the country’s OPEC quota.

Moreover, between 1993 and 1999, a policy of la apertura, under the direction of Luis Giusti, Sosa Pietri’s successor as the chairman of PDVSA, set Venezuela on a course which ‘incentivised’ foreign investment by exempting certain projects from the basic petroleum fiscal regime. In January 1996, PDVSA launched the largest round of international bidding on oil exploration and production rights since nationalisation in 1975, making it possible for IOCs to return to the country. Giusti thus continued his predecessor’s policy and pushed it to extremes. Until 1999, Venezuela’s oil industry thus maintained an anti-statist and MNC management culture much throughout its existence. Following la apertura, Venezuela arguably defected from OPEC into the opposite camp.

500 “Chávez’s Battle to Keep the Oil Flowing,” *The Economist*, August 2, 2003, p. 36.
501 Mendoza is an oil industry expert, who briefly served on the PDVSA board of directors in the days leading to the April 11, 2002 coup d’état attempt. Ibid. Besides, the 1975 Nationalization Law stated that “in special cases and if it convenient for the public interest, the National Executive [or the state-owned enterprises to be founded] may agree in joint ventures with private enterprise for a fixed time, with a participation guaranteeing the control of the state... Both Houses of Congress will have to authorise them beforehand in joint session...” *Nacionalización del Petróleo en Venezuela* (Caracas: Catalá/Centauro/Editores, 1975), pp. 3-4. Bernard Mommer argues that those special cases related mainly to foreign capital. “The Political Role of National Oil Companies in Exporting Countries: The Venezuelan Case,” *Oxford Institute for Energy Studies, Working Paper*, no. 18, September 1994, p. 14.
506 The ties to the former owners of the nationalised Venezuelan companies were maintained primarily through technical assistance contracts, and through commercialisation contracts, which heavily discounted the price of oil to their former owners. “The Political Role of National Oil Companies in Exporting Countries: The Venezuelan Case.” Also, see Rutledge, *Addicted to Oil*, p. 87. For analysis of oil policy before the Chávez government, see Luis E. Lander “La Apertura Petrolera en Venezuela: de la Nacionalizacion a la Privatizacion,” *Revista Venezolana de Economia y Ciencias Sociales*, vol. 4, no. 1 (January-March 1998), pp. 153-182; and Mommer, *The New Governance of Venezuelan Oil*, p. 76.
In 1998, Bernard Mommer argued that Venezuela “underlines the spread of the new liberal governance structure of international oil elsewhere. Hence, the trend in the governance of international oil at present is in precisely the opposite direction to that in the decades before the ‘OPEC revolution’.” Mommer also argued that “looking to the future, PDV, the producing company, will be privatised” and “will only survive as far as required in its new role as a licensing agency in a position strong enough to ward off the state and to limit its sovereign rights over the natural resource.” Nationalisation, according to Mommer, “has already been defeated, definitively, radically, and irreversibly.” His predictions were to be proven incorrect by 1999 when Hugo Chávez, explicitly targeting la apertura, became Venezuela’s president.

A radical nationalist and socialist who had grown up in the military, Chávez had unsuccessfully tried to overthrow the government in 1992 through a military coup. Arrested and released from prison after two years, he had then decided to use political and constitutional means to come to power, setting a program that promised Venezuelans to free the country from poverty and corruption, and to break the traditional concentration of wealth in the hands of small elite. During his first three years in power, Chávez took bold steps to overhaul Venezuela’s institutions and attempted to redress the country’s social ills, justifying the hopes of many Venezuelans who had supported him. However, his policies also provoked economic problems, and a backlash from those who were losing their power.

Thus, in recent years, under the influence of President Chávez, Venezuela’s oil industry has been reformed, PDVSA’s autonomy has been reduced and the rules regulating the country’s hydrocarbons sector amended. The changes brought up by la apertura, were reversed. PDVSA was placed under the jurisdiction of the Ministry of Energy and Petroleum (MEP), in practice controlled by Chávez, and has lost all of its earlier independence. This is not surprising since Chávez was Giusti’s long-standing opponent declaring that PDVSA was “a state within a state,” and blaming its executives for lavish spending. The reform encompassed four main areas: solidification of state ownership of the oil industry, tax reform, subordination of the oil industry to national interests, and the strengthening of OPEC. I will briefly discuss three of them, while the fourth one – tax reform – will be discussed in the next section.

The privatisation of PDVSA is banned under Venezuela’s 1999 Constitution. The new constitution anchors state ownership of Venezuela’s oil industry by stating, “For reasons of economic and political sovereignty and national strategy, the state shall retain all shares of Petroleos de Venezuela, S.A. or the organ created to manage the petroleum industry.” This

509 Ibid, p. 77.
510 Ibid, p. 76.
512 Rutledge, Addicted to Oil, p. 91.
515 Ali Rodríguez, the former president of OPEC and current president of PDVSA provides a good summary of the policy in “La Reforma Petrolera Venezolana de 2001,” Revista Venezolana de Economia y Ciencias Sociales, no. 2, May/August 2002.
517 Constitution of the Bolivarian Republic of Venezuela, Article 303, 1999. A backdoor to privatisation remains open because the constitution also says that the state shall own all shares of PDVSA, “except those of subsidiaries, strategic associations, businesses, and whatever other that has constituted or constitutes PDVSA as a result of the development of its business.” In other words, in theory, PDVSA could turn its various activities into subsidiaries and then sell them off, one by one. However, in practice, it will enable PDVSA to sell unprofitable subsidiaries.
article of the constitution marks a definitive break from neo-liberal policies that PdVSA had been pursuing prior to Chávez’s election. In practice, all oil and other hydrocarbon reserves within Venezuela are owned by Venezuela and not by the firms that discovered, or who operate them. The MEP supervises the state of the industry, trade and operations, and designs the governmental energy policy, which is overlooked by Chávez. PdVSA is the operator, as it coordinates, monitors, and controls all hydrocarbon operations.

When Chávez came to power, in February 1999, one of his highest priorities was to strengthen OPEC and raise the market price of oil.\textsuperscript{518} Oil had dropped to less than $10 per barrel, to an extent because Venezuela was ignoring its OPEC production quotas during the previous government(s).\textsuperscript{519} Within the new government’s first 100 days, Ali Rodríguez, a former president of OPEC and then a new Minister for Energy and Petroleum, visited most OPEC countries and returned with a commitment from most of these countries to reduce production and abide by their OPEC quotas.

Today, Venezuela is important to world oil markets because it holds the sixth largest proven oil reserves in the world, and the largest outside the Middle East, amounting to 79.7 billion barrels in 2005, excluding billions of barrels of extra-heavy oil and bitumen.\textsuperscript{520} Further, Venezuela ranks as the world’s ninth largest producer and fifth largest exporter of crude oil. The oil industry is the mainstay for Venezuela’s economy, accounting for 85 percent of total export revenues, 52 percent of total government revenues, and about one-third of GDP.\textsuperscript{521} Venezuela had a functioning democracy and the highest per-capita income on the South American continent before the oil boom in the 1970s.\textsuperscript{522} However, by the early 2000s, the country’s per-capita income was lower than in it was in 1960. Hence, Venezuela is usually considered a ‘rentier’, or petro-state, suffering from the ‘resource curse’ or the ‘Dutch Disease’.\textsuperscript{523}

In 2002 and 2003, Venezuela’s oil output fell, largely because of difficulties at the state-owned PdVSA. Political conflict and unrest, particularly a nationwide strike beginning in early December 2002,\textsuperscript{524} compounded the deteriorating situation of the country’s economy, which contracted by 8.9 percent in 2002 and 9.2 percent in 2003. This nationwide strike, organised by opponents of President Chávez, was also joined by the employees from PdVSA, shutting down a large portion of the country’s oil industry and drastically reducing the production of Venezuelan


\textsuperscript{520} BP Statistical Review of World Energy 2006. There is as much as 270 billion barrels of extra-heavy oil and tar-like bitumen in the Orinoco Tar Belt.

\textsuperscript{521} See “Hugo Chávez’s Venezuela,” The Economist, May 14, 2005, p. 24; and “Venezuela Country Analysis Brief.”


President Chávez declared the strikers’ demands, which called for an early referendum on the President’s rule, unconstitutional and dismissed around half (18,000) of PdVSA’s employees (32-40,000). Chávez then took full control of the company, and in December 2004, inaugurated Rafael Ramirez, a political loyalist, in charge of both PdVSA and the MEP. In 2003, Chávez also imposed an ideological set of guiding principles upon PdVSA, the most notable of which were subordination to the state, and high consciousness of national sovereignty, and the firm’s de facto strategy has become to maximise transfers to social programs.

After a strike that resulted in a near complete shutdown of PdVSA’s operations in late 2002 and the early months of 2003, and the departure of company’s most experienced managers, oil production levels in Venezuela remained lower than before the strike. In 2005, Venezuela’s total crude oil production was 3 million bpd, 15.3 percent higher than in 2003, but still more than 4 percent short of pre-strike production (see Table 4.1 and Figure 4.1). At the same time, in recent years Venezuela consumed between 500,000 and 600,000 bpd, allowing between 2.1 and 2.7 million bpd being available for exports. Historically, Venezuela’s production and exports peaked in 1970, when they were 25 percent (production) and 44 percent (exports) higher than they were in 2005 (Table 4.1). It is interesting to note that PdVSA is one of the top five integrated oil firms in the world as besides domestic refining capacity, it also has holding interests in approximately 15 refineries outside Venezuela, mainly in the US, the Caribbean, Germany, Sweden and the UK. PdVSA’s total refining capacity of 3.1 million bpd positions it as the fourth largest refining firm in the world. As PdVSA is a state-owned company, between 1996 and 2005, its total payments to the Venezuelan government in dividends and taxes averaged $10.8 billion per year.

Table 4.1: Venezuela’s Crude Oil Production and Consumption (Selected Years and 1998-2005)

<table>
<thead>
<tr>
<th>Year</th>
<th>Production (mbpd)</th>
<th>Consumption (mbpd)</th>
<th>Balance (mbpd)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1970</td>
<td>3.754</td>
<td>0.211</td>
<td>3.543</td>
</tr>
<tr>
<td>1985</td>
<td>1.744</td>
<td>0.370</td>
<td>1.374</td>
</tr>
<tr>
<td>1998</td>
<td>3.480</td>
<td>0.475</td>
<td>3.005</td>
</tr>
<tr>
<td>1999</td>
<td>3.126</td>
<td>0.474</td>
<td>2.652</td>
</tr>
<tr>
<td>2000</td>
<td>3.239</td>
<td>0.496</td>
<td>2.743</td>
</tr>
<tr>
<td>2001</td>
<td>3.141</td>
<td>0.545</td>
<td>2.596</td>
</tr>
<tr>
<td>2002</td>
<td>2.916</td>
<td>0.594</td>
<td>2.322</td>
</tr>
</tbody>
</table>

525 Venezuela’s production dropped from 3.3 million bpd in November 2002 to about 700,000 bpd in January 2003. “Venezuela Country Analysis Brief.”
526 Ibid.
528 For more of these guiding principles, see http://www.pdvsa.com.
529 Mares and Altamirano, “Venezuela’s PDVSA and World Energy Markets,” p. 64.
530 Petroleum Intelligence Weekly, December 2006.
531 Giacomo Luciani and Mario Salustri, “Vertical Integration as a Strategy for Oil Security,” in Paul Stevens (ed.), Strategic Positioning in the Oil Industry: Trends and Options (Abu Dhabi: The Emirates Center for Strategic Studies and Research, 1998), p. 32. Of PdVSA’s total refining capacity, 1.28 million bpd is domestic. The rest is refined mainly in the U.S. (865,000 bpd through CITGO), in the Caribbean (U.S. Virgin Islands, the Netherlands Antilles) and in Europe (Sweden, Germany, Finland, Belgium, UK). “Venezuela Country Analysis Brief.” For more on PdVSA, see Mares and Altamirano, “Venezuela’s PDVSA and World Energy Markets”.

A vast majority of Venezuela’s total oil exports go to the United States. The U.S. share of Venezuela’s oil exports has been at, or above, 50 percent every year since 1985, with the peak of over 65 percent in 2003. At the same time, Venezuela has been one of the top sources of imported crude for the United States, often having a larger share than Saudi Arabia. Its share in total U.S. crude oil imports has been above 10 percent in every year since 1983, with the peak of 17.7 percent in 1996. In absolute terms, Venezuela’s oil exports to the U.S. peaked in 1997, with almost 1.8 million bpd. 533 Thus, the two countries have historically been dependent on each other, and “oil looms large in the realm of U.S.-Venezuelan relations.” 534 Venezuela has been dependent on the United States for petro-dollars needed to fill up its budget, and the United States has been dependent on Venezuela as a geographically proximate, safe and reliable source of crude oil. 535 After all, until December 2002 strike Venezuela had been a steady supplier of oil for more than seven decades and had never suffered a complete halt in its oil production. 536

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533 All data in this paragraph has been derived from EIA and BP websites.
535 As a non-Arab and non-Middle Eastern member of OPEC, Venezuela had continued exporting oil during the 1973 Arab oil embargo and had provided additional supply during the shortages brought on by the 1991 Gulf War. Additionally, it only takes six days for Venezuelan oil to reach U.S. shores, which reduces costs and allows Venezuela to quickly compensate for supply problems in other regions of the world, from where it often takes at least a month to get oil to the U.S. Michelle Billig, “The Venezuelan Oil Crisis,” Foreign Affairs, vol. 83, no. 5 (September/October 2004), p. 3.
536 Ibid, p. 4.
Venezuelan strike was the first time that the U.S. oil supply was significantly disrupted by strife in a region other than the Middle East.\textsuperscript{537}

In line with the strategy of diversification of sources of imported oil, the U.S. \textit{National Energy Policy} (NEP) of 2001 recommended pressuring and cajoling leaders of non-Gulf producers to increase their exports to the United States. The report places special emphasis on the producers in Latin America (notably Venezuela, Mexico and Colombia), as they possess large reserves, are geographically close, and fall within the U.S. sphere of influence.\textsuperscript{538} In order to meet the growing American need for oil imports, these countries will need substantial investment in new infrastructure to boost production in older, mature fields, which are yielding less, and start the development of the new ones. In order for this to take place, it is argued that the U.S. should intensify its efforts to promote greater ‘energy integration’ with nations within the western hemisphere.\textsuperscript{539} ‘Energy integration’ means opening up Venezuela and other oil exporters in the western hemisphere to U.S. oil companies.\textsuperscript{540}

However, Chávez opposes any deeper American, or other Western involvement in the country’s oil industry. Chávez’s opposition to their involvement stems from his economic imperialist understanding that the MNCs are intimately linked with their home government, and their policies inextricably related. According to such theories, to which Chávez clearly subscribes, the government needs the economic power of the MNC to help expand its political reach, and the MNC needs the government to protect it from other governments, as well as to help maintain orderly conditions when stability is threatened.\textsuperscript{541} The source of Chávez’s hostility towards Americans comes from the fact that the Bush administration provided funds to some of the anti-government organisations in Venezuela,\textsuperscript{542} and U.S. intelligence agencies provided support to Venezuelan military personnel who had briefly toppled Chávez in April 2002.\textsuperscript{543} The United States also rushed to bless the new military regime that had temporarily removed Chávez from power, only to discover that two days later he was freed by military units that had remained loyal to him and returned to power.\textsuperscript{544} The Venezuelan president enjoyed far stronger support than expected. In response, Chávez has repeatedly threatened to retaliate by cutting off oil deliveries to the United States.\textsuperscript{545}

It becomes certain that the American and other Western IOCs will have significant problems assembling the necessary capital needed to maintain or expand Venezuela’s production, and therefore its exports to the United States. In past, private, profit-driven IOCs were not likely to invest vast sums of money unless they could exercise a significant degree of control over local

\textsuperscript{537} Ibid, p. 2.
\textsuperscript{539} Rutledge, \textit{Addicted to Oil}, p. 67.
\textsuperscript{540} Ibid, p. 68.
\textsuperscript{542} Klare, \textit{Blood and Oil}, p. 128.
\textsuperscript{543} Washington hoped that by replacing Chávez with someone less anti-American, the United States could better ensure that Venezuelan oil would keep flowing to American refineries. Roberts, \textit{The End of Oil}, p. 255. Also, see Eva Golinger, \textit{The Chávez Code: Cracking US Intervention in Venezuela} (Northampton, MA: Olive Branch Press, 2006); and Engdahl, \textit{A Century of War}, p. 266.
\textsuperscript{544} Maugeri, \textit{The Age of Oil}, p. 190.
operating conditions and somehow insulate themselves from other problems, and in very few cases, they would receive the required assurances, and therefore pursue their investments. However, as outlined in Chapter 2, and as evident from oil industry bargaining in Russia (Chapter 3), IOCs have extremely limited options for investing their money in order to increase reserve base and production. Their bargaining power vis-à-vis Venezuela is very low, particularly due to the emergence of oil-importing countries’ NOCs as competitors. Does Chávez have these NOCs in mind to replace the IOCs present in Venezuela? If so, given the special emphasis placed on Venezuela in the 2001 NEP, will the U.S. easily give up on Venezuela’s oil and on American IOCs engaged there?

### Table 4.2: Goals of Main Actors in Oil Industry Bargaining in Venezuela

<table>
<thead>
<tr>
<th>Actor</th>
<th>Bargaining Goals</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hugo Chávez and the Venezuelan government</td>
<td>Maintaining regime stability; keeping the US at bay by establishing friendly relations with other developing countries; high oil revenues</td>
</tr>
<tr>
<td>The U.S. government</td>
<td>Steady inflow of Venezuelan oil; possibly regime change in Venezuela, which would be friendlier to American IOCs</td>
</tr>
<tr>
<td>The government of the PRC</td>
<td>Increasing oil imports from Venezuela</td>
</tr>
<tr>
<td>Western IOCs</td>
<td>Maintenance of their Venezuelan operations; taxes as low as possible</td>
</tr>
</tbody>
</table>

In order to restore its oil sector and increase current levels of production, Venezuela is needy of foreign investment. However, IOCs are discouraged from investment because of Venezuela’s 2001 Hydrocarbons Law, which came to effect in January 2002, and to practice in October 2004. This law replaced the Hydrocarbons Law of 1943 and the Nationalization Law of 1975. The new Hydrocarbons Law raised royalties paid by private companies to 20 – 30 percent from the previous 1 – 16.66 percent, and from 1 to 16.66 percent for those producing from the tar sands (for example in Orinoco Belt). At the same time, the government increased a corporate tax rate for oil companies from ‘preferential rate’ of 34 percent to 50 percent. The tax rate was to be applied retroactively to profits made between 2000 and 2005. All of this implies that Venezuela has been trying to change and re-negotiate contracts with IOCs present in the country. By shifting its emphasis from income taxes to royalties, the government is closing loopholes in the tax collection process. The law also guaranteed PdVSA at least 51 percent stake in any project regarding exploration, production, transportation and initial storage of oil. With new measures, the government has been putting increasing pressure on all foreign companies, including France’s Total, Italy’s ENI, Spain’s Repsol, Statoil, Norway’s NOC, the UK’s BP and U.S. companies Conoco Phillips, Chevron and Exxon Mobil, with existing operating agreements to change over to the new regime.

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546 Klare, Blood and Oil, p. 123.
547 De jure, the tax rate for hydrocarbons production was 67.7 percent. However, the oil companies were de facto subjected to the 34 percent rate applicable to the non-oil sector. The de facto increase in corporate tax rate for hydrocarbons, from 34 to 50 percent in 2001 was de jure a drop from 67.7 percent to 50 percent.
549 “Venezuela Country Analysis Brief.” Taxes based on oil income are difficult to control because PdVSA or other oil companies deduct their expenses from the income on which they have to pay the taxes. Since expenses are not that easily identifiable for an outside auditor, the taxpayer can attempt to inflate expenses, in order to lower their tax payments.
550 Ibid.
The new law came into practice on 10 October 2004, when Chávez surprised the IOCs by announcing on his weekly radio broadcast that he was increasing royalties paid to the state by companies involved in heavy crude production in the Orinoco Tar Belt. Chávez noted that higher oil prices justified the increase, as oil companies were earning substantially higher profits. In the following week, Stratfor suggested that Chávez’s decision revealed that the Venezuelan government was anxious to get its hands on a greater share of oil revenues, despite record high oil prices. It also showed that Chávez recognised that his political control could be undermined if he lost the support of the lower classes, putting pressure on the budget to increase social spending. Besides $6.9 billion that he channelled through PdVSA to support social expenditures, Chávez clearly needed more money to fund his Bolivarian Revolution, both at home and abroad.

The affected companies signed strategic association agreements in the mid-1990s for the production in the Orinoco Belt. These strategic associations, as well as 32 other operating service agreements with private companies, were signed on very favourable terms for the companies, and they reflected la apertura and the overall cooperative FDI climate of the 1990s, as some have argued that Venezuela went through an informal privatisation in the 1990s. In addition, the low corporate tax rates and royalties associated with the initial contracts were designed to offset the high investment costs needed to set up the upgrading and conversion process for this type of production. Due to new contracts, the IOC share in Venezuela’s oil output grew from 300,000 bpd in 1998 to 1.2 million bpd in 2004.

Chávez’s decision did not come as a surprise to a follower of events in Venezuela, as he has long railed against what ‘sweetheart’ deals afforded foreign oil companies in Venezuela, and has taken steps for remedy three years prior to his October 2004 decision. Thus, the 2001 Hydrocarbons Law was a legal basis for his action. In announcing the royalty and oil corporate tax increase, Chávez announced that “today, we are starting the second phase of the true nationalisation of PdVSA and of Venezuela’s oil, aiming for full petroleum sovereignty.” Concurrently, Venezuela’s new Energy and Petroleum Minster Rafael Ramirez stated, “We are working on becoming a tool for the state to recover its sovereignty. When the private companies have control over production, it’s impossible to conduct your own national oil policy.”

A telling sign of the emerging adverse political climate in Venezuela came in January 2005 when PdVSA officials ordered the Houston-based firm Harvest Natural Resources to cut production by one third, a step that sent the company’s stock price tumbling. Moreover, on 14 April 2005, Ramirez announced that operating strategic agreements between PdVSA and foreign companies would be terminated from 31 December 2005, with a grace period of six months for companies

552 Ibid.
553 Ibid.
554 The figure is for up to 2005, and includes programs related to education, healthcare, job creation, and subsidised food distribution. For more details, see Mares and Altamirano, “Venezuela’s PDVSA and World Energy Markets,” pp. 46-7 and 58-63.
555 “Global Market Brief,” Stratfor, October 18, 2004. These are Petrozuata (PdVSA 49.9 %; Conoco Phillips 50.1 %), Cerro Negro (PdVSA 41.67 %; Exxon Mobil 41.67 %, BP 16.66 %), Sincor (PdVSA 38 %, Total 47 %, Statoil 15 %) and Hamaca (PdVSA 30 %, Conoco Phillips 40 %, Chevron 30 %). “Venezuela Country Analysis Brief.”
557 “Hugo Chávez’s Venezuela,” The Economist. Of which, four strategic alliances (or JVs) in the Orinoco Belt account for approximately 622,000 bpd.
560 Ibid.
who are parties to operating contracts. Upon termination, operating strategic agreements would be converted into joint ventures (JVs) in which the government would have a 51-70 percent stake of the equity, and in addition, there was to be an increase in the income tax for the IOCs.

There has been no suggestion that any compensation was to be paid to foreign oil companies for abandoning their rights under current operating agreements. All of the operating agreements currently in force in Venezuela have dispute resolution clauses, which provide for international arbitration. The new Hydrocarbons Law, however, requires all new contracts to contain the following clause:

Any doubts and controversies of any nature that may arise from the agreement and that may not be amicably settled between the parties, including arbitration in cases permitted by the law on the matter, shall be settled by the competent courts of the republic [of Venezuela] pursuant to its laws, and may not give rise to any foreign claims for any reason whatsoever.

This clause is dangerously ambiguous as it clearly establishes Venezuelan law and jurisdiction as the ‘default’ clause if no arbitration clause is included in the contract. Thus, it is possible to interpret the clause as an attempt to exclude foreign arbitration clauses altogether, and the result could cause uncertainty for the IOCs.

There was no shortage of disturbing news for the IOCs, as it came out in May 2005 that the IOCs operating in the country have been compared to Yukos and ordered to pay between $2 and 3 billion in back taxes for the last ten years. For illustration, in early August, 2005, Royal Dutch/Shell’s office in Maracaibo, city in western Venezuela, was closed by the Venezuelan tax agency for challenging its $132 million tax bill, which was given to Shell in July 2005. High oil prices meant that other IOCs had to acquiesce, or face similar problems. Rafael Ramirez said, “Most companies are willing to pay, and they are paying.”

By October 2005, 22 of the 32 operating agreements signed by foreign oil companies with PDVSA have been migrated to the new regime, and in late 2005, Caracas reaffirmed that future investments in the Orinoco Tar Belt would be subject to higher royalties and that the current terms would be renegotiated at some point. Initially, the affected IOCs have said publicly only that they were studying the matter, and they were very unlikely to pull out of the projects. However, the 2001 Hydrocarbons Law clearly discouraged the IOCs from any new investment.

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562 “Hugo Chávez’s Venezuela,” The Economist.
563 Ibid.
564 Article 34 b) quoted in ibid.
565 Ibid.
566 This has no legal foundation, as “the 2001 Hydrocarbon Laws are not retroactive. They only apply to new licenses, concessions or contracts, not to the old ones.” Mommer, “Venezuelan Oil Politics at the Crossroads.”
569 Schwartz, “Oil’s New Mr. Big,” p. 58.
573 Ibid.
in Venezuela, as higher royalties and the limitations placed on JVs made FDI very unattractive. The new tax regime will most likely have a negative effect on balance sheets of foreign oil companies in Venezuela, and in future, PdVSA will be able to use its controlling interest in all JVs to direct the decision-making process.\(^{574}\)

On 1 April 2006, Venezuela’s government took control of two oilfields, one operated by France’s Total and the other by ENI of Italy, after the companies refused to sign up to new arrangements converting their operating contracts into JVs in which PdVSA will have a majority stake. Ramirez claimed that Venezuela does not need companies that refuse to adjust to the new terms, and that Total and ENI would not be compensated for the fields they lost.\(^{575}\) ENI, which has invested some $1.65 billion in its 60,000 bpd field, lost $900 million, while Total lost approximately $320 million.\(^{576}\) Exxon Mobil earlier sold a minority stake in a small, 15,000 bpd field to Repsol, the field’s operator, to avoid the change and confrontation with the government,\(^{577}\) but it remained active in a bigger, heavy oil project.

In late April 2006, after all 32 oil fields have been shifted to joint ventures, rumours have started that four heavy oil projects in the eastern Orinoco River basin, where Exxon Mobil, Chevron, Total, BP, Conoco Phillips and Statoil convert extra heavy crude into 600,000 bpd of synthetic crude using specialised refineries,\(^{578}\) could follow suit in near future.\(^{579}\) This was just “a matter of time” according to Juan Carlos Sosa Azpurua, president of Grupo Petroleo YV, a Caracas-based energy consultancy.\(^{580}\) It was suggested that the companies involved could see income taxes increased to 50 percent from 34 percent and royalties hiked to 30 percent from 16.66 percent, as according to the new law.\(^{581}\)

Indeed, it did not take long for these rumours to materialise. On 8 May 2006, Chávez increased royalties for all companies involved in the country not to 30, but to 33.3 percent.\(^{582}\) This measure was to affect the abovementioned companies extracting heavy crude in the Orinoco tar belt, as this area had been exempt from higher royalties in past due to higher investment needs. The income tax was also raised, as predicted, to 50 percent from 34 percent. Rafael Ramirez indicated that the new policies were not open for negotiations: “We don’t have anything to discuss with the companies … The companies have to adjust.”\(^{583}\) Finally, in late February 2007, Chávez signed a decree for the government to take a majority (60 percent) stake in four heavy crude upgrading projects in the Orinoco River basin by 1 May 2007.\(^{584}\)

\(^{574}\) “Venezuela: Proposed Measures against Oil and Gas Investors,” p. 2.


\(^{577}\) “Leaving the Door Ajar,” The Economist, April 8, 2006, p. 43.

\(^{578}\) The companies have invested a combined $16 billion in developing the technology and infrastructure to extract tar-like bitumen and convert it into lighter, more marketable crude at the giant Jose refinery. The Orinoco projects in eastern Venezuela differ markedly from the 32 oil fields where the state has already taken a majority share, because companies operating in the Orinoco, unlike in the other fields, own the bulk of the infrastructure in the area.

\(^{579}\) Eulogio Del Pino, a director of PdVSA suggested this cause of action. The government should “do the job completely and the participation of the state should be 51 percent.” See “Venezuela to Expand Joint Oil Ventures,” Washington Post, April 23, 2006.


\(^{581}\) Ibid.


\(^{583}\) Quoted in Obiko Pearson, “Chavez Tax Targets Foreign Oil Companies.”

All the measures taken by Venezuela serve as evidence that the 2001 Hydrocarbons Law has been applied in practice, and that Venezuela is in a strong bargaining position vis-à-vis the IOCs. With demand for oil booming and the majority of reserves shut out to foreign investment in the Middle East, oil companies have had no choice but to accept the new terms in Venezuela, and “[t]he negotiating position of countries with reserves has strengthened.” In the Western hemisphere, Canada already has new projects under way, and Mexico’s reserves are in decline, improving Venezuela’s chances for achieving favourable terms on new projects.

Ramirez is not just setting his sights on foreign firms in Venezuela. He wants PDVSA to work with NOCs in countries such as Iran, Saudi Arabia and Algeria so that the NOCs can wrest even more power away from the likes of Exxon Mobil and other IOCs: “This does not mean we will refuse to work with private companies,” says Ramirez. “But when oil companies have the high hand over a country, there is no way for a country to resist the pressure coming from these companies.” Thus, PDVSA found new partners for Orinoco JVs – NOCs from political allies, including Brazil, Iran, Russia, Argentina, Spain, China, India, Uruguay, Bolivia, Ecuador, Belarus, and Vietnam, operated with technology purchased off the shelf. For example, one of the NOCs involved, China’s CNPC, received a best production technology award for its achievements in heavy oil recovery during 2006. While PDVSA is to develop 14 blocks in the Orinoco Belt on its own, the other 13 blocks will be developed through JVs with other NOCs who will have at most 49 percent ownership. This is an obvious sign that Caracas intends to use its billions of barrels of heavy oil as bait to secure pragmatic diplomatic alliances. Venezuela, therefore, has an ‘ace up its sleeve’ in negotiating with Big Oil – NOCs eager for a foothold. Any Western corporation that exits Venezuela could eventually be replaced by a Chinese, Indian, Russian or some other country’s NOC. As Ramirez says, “There is a lot of interest from China and India, that’s a brand new condition…. Yes, they have huge, deep pockets.”

After being triumphant in his policy, Chávez declared, “We [Venezuela] have buried that perversion that was the oil opening. Anyone who doesn’t like that can go elsewhere.” However, according to The Economist “most of the multinationals are not leaving” and “Venezuela is still worth being in,” as “few countries with abundant reserves are open to foreigners.” For example, the head of Royal Dutch/Shell’s operations in Venezuela, Sean Rooney did not complain after the tax hike was imposed retroactively:

The government of Venezuela is auditing the majority of oil companies’ returns. We were lucky enough to be the first. It is hard to turn away from the tremendous opportunities in Venezuela. The Venezuelans can and will be extracting higher rents, and we expect and accept this. We are prepared to pay more when the opportunity merits.

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586 Ibid.
587 Schwartz, “Oil’s New Mr. Big,” p. 57.
590 Schwartz, “Oil’s New Mr. Big,” p. 59.
591 Quoted in “Leaving the Door Ajar,” The Economist, April 8, 2006, p. 43.
592 Ibid.
593 Schwartz, “Oil’s New Mr. Big,” p. 58.
In addition, Chevron, just like Royal Dutch/Shell, has adopted a remarkably accommodating stance towards Venezuela. Although tax auditors raided a Chevron office in Maracaibo in July 2005, the company was not protesting while it awaited a possible back-tax bill. Vice chairman Peter Robertson insisted Chevron had “a good, excellent relationship with Venezuelan government.” His boss, CEO Dave O’Reilly, added, “Venezuela will work its way through this. Ramirez is a very straight shooter.” Indeed, O’Reilly said Chevron would like to invest more in Venezuela. According to Luis Giusti, former president of PDVSA, “the foreign companies will accept [Chávez’s] decisions because they have so much capital sunk there, and they can’t afford a confrontation with the government.”

The only foreign giant initially fighting hard against Venezuela’s moves was Exxon Mobil. It was threatening to sue the Venezuelan government and bring international arbitration proceedings, citing the legal sanctity of the original contracts. However, Ramirez was betting it would not go that far: “I have a hunch that they will finally read the clauses of the contract and realise we are right.” An Exxon Mobil spokesperson said that while arbitration remained an option, the company “wishes to explore an amicable resolution.” Exxon Mobil was at a particular disadvantage in dealing with Venezuela, as it had “developed a reputation for arrogance that has at times rankled host governments” under the lead of Lee Raymond. In Russia, Lee Raymond’s high-handed manner in pursuing Yukos without government blessing offended Vladimir Putin. Raymond’s abrasive style also reportedly annoyed Saudi Arabia’s oil minister so much that it was partly responsible for failing to materialise a big investment deal. Raymond’s retirement in 2006 caused a change in ways Exxon Mobil deals with oil producing governments. Firstly, the company decided not to pursue matters in Venezuela any further, and as shown above, sold its small stake to Spain’s Repsol. Secondly, in late February 2007, after Chávez signed a decree for the government to take a 60 percent stake in four heavy crude upgrading projects in the Orinoco basin by 1 May 2007, Exxon Mobil announced plans to hand its $30 billion Cerro Negro operations to the Venezuelan state before deadline. Chevron was also expected to accept the new terms. As of early May 2007, all companies, but ConocoPhillips, have agreed to state control, and it is likely that ConocoPhillips will follow suit due to Chávez’s expropriation threats.

Chávez vs. the United States

For Chávez, American might is reflected in the continuing operations of major U.S. IOCs like Exxon Mobil and Chevron in Venezuela, and this is something that had to be changed. As discussed above, PdVSA raised the royalties and the corporate tax rates, and reviewed the terms of 32 existing contracts with foreign oil corporations, turning most of them into JVs what gives the state a majority share. Chávez, now fully in control of PdVSA, which has become his foreign policy tool, seems determined to use his country’s vast oil reserves as a weapon against...
the Bush administration. In a statement that affirms this, he stated that “[Venezuela has] a strong oil card to play on the geopolitical board … against the world’s roughest players, the United States.” Moreover, Chávez is sending signals that he wants to do less energy business with the United States and more with other countries. In a move that would clearly indicate his ambition to reduce oil exports to the U.S., Chávez appears set on reducing the size of CITGO, a big refiner and marketer of gasoline in the United States and a wholly owned subsidiary of PDVSA, and at reducing Venezuela’s oil exports to the United States. Although as of late 2006, Venezuela was still the fourth largest supplier of crude oil and products to the U.S., its exports to the U.S. dropped by 18 percent between January and June 2006. While in the first four months of 2005 Venezuela sent 190.1 million barrels to the U.S, the figure for the same period in 2006 stood at 178.2 million barrels of crude oil and petroleum products. Moreover, in July 2006 CITGO announced plans to reduce its network of U.S. gas stations by 14 percent, to 11,200, and in August 2006, this was followed by the $2.3 billion sale of 42.1 percent share in the Lyondell-CITGO refinery. In early April 2007, Rafael Ramirez sent a chilling signal to the U.S., saying Venezuela might sell refineries in Texas and Louisiana that process crude from Exxon’s Venezuelan oil fields. To some in the United States, the Venezuelan leader is starting to look like their worst hemispheric nightmare: a second Fidel Castro – but, unlike the Cuban, with lots of oil and therefore money. They accuse him not only of crushing Venezuelan democracy but also of destabilising much of Latin America by helping Colombia’s guerrillas and funnelling money to radical movements in Nicaragua, Ecuador and Bolivia.

Besides reducing American and other Western IOC presence in Venezuela, and threatening to reduce oil exports to the U.S., there are signs that Chávez wants to redirect Venezuela’s oil from the United States to China. For example, in March 2007 Chávez said that China was set to rival the United States as Venezuela’s top oil buyer. A possible impact of a decrease in Venezuelan exports to the U.S. would, at a minimum, increase U.S. reliance on oil from the Middle East, what would work against the U.S. diversification strategy as outlined in the 2001 NEP. In December 2004, President Chávez was reported to have referred to Venezuela’s long oil-producing history as “100 years of domination by the United States.” He asserted that “Now we are free and place this oil at the disposal of the great Chinese fatherland.” In January 2005, upon Chávez’s visit to Beijing, Venezuela signed 19 bilateral oil and gas agreements with China in order to increase exports to Beijing in exchange for the promise of future Chinese investment in Venezuelan oilfields. Moreover, in May 2005, the first ever tanker with 1.8 million barrels of

604 Hugo Chávez quoted in “Chávez Squeezes the Oil Firms,” The Economist, November 12, 2005, p. 43.
606 Peter Wilson, “Citgo to Drop Retail Sales in 10 States, Part of Arkansas,” Bloomberg.com, July 13, 2006.
609 Romero and Krauss, “High Stakes”.
610 Romero and Krauss, “High Stakes”.
611 How Big a Threat is Hugo Chávez?” The Economist.
crude left Venezuela for China, and in August 2005, Venezuela opened its first oil office in China. After exporting only 12,300 bpd in 2004, in 2005, Venezuela exported 65,500 bpd of crude oil and products to China. However, after the signing of two contracts for crude and fuel oil between CNPC and PDVSA in November 2005, Venezuela was to double oil sales to China, to 160,000 bpd average in 2006, with ambitious plans to bring this to 300,000 by the end of 2006, 500,000 bpd by 2010, and 1 million bpd by 2012. In announcing Venezuela’s future plans in March 2007, after meeting with CNPC officials, Chávez said, “As a power, the United States is going down, while China is moving up.” Thus, “When we [Venezuela and China] begin speaking of 1 million barrels of crude, we’re nearing the level of Venezuelan supplies to the United States”. Although these ambitious plans did not materialise by January 2007, when China imported around 135,000 bpd from Venezuela, Venezuela’s oil exports to China have been on the constant rise.

Beyond oil, Venezuela bought a Chinese communications satellite in 2005, to be named ‘Simón Bolívar’ and launched in 2008. It has also purchased Chinese radar equipment to monitor its borders, and it is interested in working with the Chinese to upgrade its ageing air force, since the purchase of Spanish military aircraft was blocked by the United States in January 2006 on the grounds of a 1976 act permitting it to prevent the transfer of U.S.-sourced technology. The two countries are even cooperating on the internet. The oil-industry source says members of PDVSA travelled to Beijing to learn techniques for eavesdropping on internet traffic.

However, some have cautioned that both countries will have to overcome major obstacles before China can become a significant alternative to the United States. One problem is geography, as Venezuela has no outlet on the Pacific Ocean. Another is logistical, as PDVSA’s shipping fleet consists of relatively small vessels that can reach American shores within a week, much shorter period than to reach China. The company lacks super tankers, needed to reach the Far East. A third impediment is China’s energy infrastructure, which lacks refineries capable of processing Venezuela’s high-sulphur brand of crude.

Since there is a strong interest for cooperation on both sides, steps have been taken to overcome all of these obstacles, and the Chinese have invested in transport networks to help take its purchases home. Firstly, there have been indications that up to a $4.7 billion pipeline will be constructed from Venezuela, through Colombia and then to the Pacific Coast. This would enable Venezuelan crude to bypass the U.S.-controlled Panama Canal. The two countries have been moving forward on the pipeline plan, and China has been interested in funding this project. This pipeline would reduce the tanker trip to China by ten days. China has also expressed interest in constructing and financing various projects to modernise the Panama Canal. Secondly, China and PDVSA are building a large fleet of their own super tankers which, when built, can be

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618 Cited in “Chavez: China to Become a Top Client.”
620 Ibid.
622 Ibid.
utilised to carry Venezuelan crude. In May 2006, PdVSA announced that it planned to buy 18 oil tankers from Chinese shipyards at a cost of $1.3 billion to allow for increased shipments to China. Moreover, in March 2007, Chávez said the two countries decided to start a joint oil shipping company with its own tankers to carry crude and other products between Venezuela and China. Thirdly, China is building a number of refineries along its coast in order to be able to process more of Venezuela’s high-sulphur crude. For example, in March 2007, Chávez announced plans for Venezuela and China to build three refineries in China that will process a total of 800,000 bpd of heavy Venezuelan crude, which according to Chávez, will be ready “within two or three years.” Until then, sales to China do not necessarily have to be direct, as they can be channelled through other major refining centres, such as Singapore, where they are processed, and then shipped to China.

As evident from its interests in Venezuela, China’s interest in Latin America is significant and expanding, although China’s interest in Latin America is a new phenomenon that has developed since April 2001, when President Jiang Zemin toured Latin America. China’s Venezuelan policy is part of what some analysts call its ‘south-south’ strategy – a plan to build a coalition of cooperating countries across Latin America and Africa. In the past six years, Chinese imports from Latin America have grown six fold, or by nearly 60 percent a year, as the region has become a vital source of raw materials and foodstuffs for China. Many people in Latin America in general and Venezuela in particular look to China as an economic and political alternative to U.S. hegemony and both countries “reject a ‘uni-polar’ world dominated by Washington.” Beijing’s interests in the region as a whole and in Venezuela per se, mainly focus on greater access to needed resources, primarily oil. China is a natural new partner for Venezuela. It has capital, technology, managerial skills and markets Venezuela needs to develop old and new oil fields and to sell its crude, since the government has an ambitious plan to expand oil output to 5 million bpd by 2009, mainly by bringing in NOCs. In return, Venezuela will help China diversify the sources of its imported oil. While China is a long way from threatening, or even competing with the overall U.S. influence in Latin America, the former is engaged in a pragmatic and aggressive pursuit of economic and political advantages in the region, as in many other regions of the world.

At the official level, the U.S. reaction to China’s Latin American campaign has been muted, and critics of the administration point out that it has taken its ‘eye off the ball’ while it has been engaged in the Middle East. Washington only recently showed signs of worries about China’s growing presence in Latin America in general, and Venezuela in particular, and this concern has been the subject of congressional hearings. In fact, some members of Congress view China as

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624 PDV Marina, an affiliate of PdVSA, plans to invest as much as $2.2 billion between 2005 and 2012 to build 42 new tankers, so it can ship 45 percent of its crude production by 2012, mainly in order to sell more to Asia. “Venezuela Opens Oil Office in China,” *China Daily*, www.chinadaily.com.cn, August 21, 2005.

625 Wilson, “Venezuela’s Oil Sales to U.S. Drop.”

626 “Chavez: China to Become a Top Client.”

627 Cited in ibid.

628 Ivor Williams confirmed that Venezuelan sales are already channeled though an unidentified agency.

629 Followed most recently with high-profile visits by President Hu Jintao (November 2004) and Vice-President Zeng Qinghong (January 2005).

630 Schiller, “The Axis of Oil.”

631 China has pledged investing over $100 billion in Latin America and has invested in Argentina, Bolivia, Brazil, Chile, Colombia, Cuba, Ecuador, Mexico, Paraguay, Peru, Uruguay and Venezuela.


634 “How Big a Threat is Hugo Chávez?” *The Economist*.

the most serious challenge to U.S. interests in the region since the collapse of the Soviet Union. They cite the huge financial resources China is promising to bring to Latin America, its growing military-to-military relations in the region, and its clear political ambitions there, all as potential threats to the long-standing pillar of U.S. policy in the hemisphere, the Monroe Doctrine.

In addition to its increasing cooperation with China, Venezuela has been improving relations with other non-Western powers, such as India, Iran, and Russia. In April 2006, Venezuela has begun to ship around 2 million barrels of oil per month to India, making use of India’s heavy crude refineries, for which Venezuela’s high sulphur oil is not an issue. Venezuela’s deal with India is just one part of a nascent multi-tier cooperation between the two nations in which Venezuela is helping India develop its own heavy crude fields, and India is in turn purchasing Venezuelan heavy crude and investing in the facilities necessary to refine heavy crude. While the new deal with India is relatively small, it nevertheless represents a step down a sustainable path towards diversifying Caracas’ oil markets away from the United States, and towards Asia. Moreover, in March 2005, a delegation from Tehran visited Caracas, and PDVSA employees are now getting technical training from Iran. In addition, in his July 2006 visit to Tehran, where after pledging that Venezuela would “stand by Iran at any time and under any condition,” Chávez invited Iranian investment in Venezuela’s oil industry. He received a response in August 2006, when Iran’s state-owned Petropars pledged to spend $4 billion to develop two oilfields in Venezuela.

Finally, the relationship between Russia and Venezuela has also been very close in recent years. While Chávez took the initiative in cultivating ties to Putin in 2001 when he visited Moscow for the first time in May and also in October that year, little of substance occurred in Russian-Venezuelan relations until Chávez’s third visit in November 2004, when the two sides concluded an agreement setting the stage for Venezuelan purchases of Russian arms. Agreements on energy and other matters were also signed. In February 2005, Rosoboroneksport signed a contract to sell 100,000 Kalashnikov rifles to Venezuela, and in addition to this deal, Moscow has offered Venezuela the opportunity to manufacture Kalashnikovs under license. In March 2005, representatives of the two countries signed a $120 million agreement for Venezuela to purchase nine attack and one transport helicopter, first three of which were delivered in December 2005. Additionally, there are indications that Caracas may purchase another 34 Russian helicopters and 50 MiG-29 fighter aircraft to replace its fleet of 22 American-made F-16s, which cannot fly because Venezuela cannot purchase replacement parts for them from the United States. Finally, an agreement on cooperation in the energy sphere was signed that envisions Russian firms building petrochemical and power plants in Venezuela as well as participating in oil and gas exploration, extraction, refining, and transport. Russian firms will also engage in modernising

636 Ibid.
643 Twenty-three Russian companies are to supply Venezuela with exploration and production technology – such as mobile perforation, steam injection, deep-well construction and other techniques – to help extract heavy crude. “News in Brief,” Petroleum Economist, no. 4, 2006, p. 15.
the Venezuelan coal industry. Clearly, Putin and Chávez see each other as allies against U.S.
unipolarity and hegemony, and their relationship “seems likely to continue and even intensify.”

Besides improving relations with China, India, Iran, and Russia, Chávez’s actions against IOCs contributed to similar developments in Bolivia, as in early May 2006, Bolivia’s President Evo Morales, a close friend of Hugo Chávez, signed a decree placing his country’s energy industry under state control, and claiming, “The pillage of our [Bolivia’s] natural resources by foreign companies is over.” In a May Day speech, he said foreign energy firms must agree to channel all their sales through the Bolivian state-run firm, Yacimientos Petrolíferos Fiscales Bolivianos (YPFB), or else leave the country. Although he set the firms a six-month deadline, the military and state energy officials have as of May 2006 started taking control of the oil fields and overall 56 energy installations. Of major IOCs, Exxon Mobil, Total and BP have existing operations in Bolivia. Moreover, there are strong rumours that Ecuador may follow Venezuela and Bolivia’s path by nationalising its oil and gas industry. In May 2006, Ecuador nationalised oil fields operated by Occidental, an American IOC. Evidence therefore suggests that Chávez has so far succeeded in his efforts to spread Bolivarian Revolution to the rest of Central and South America, and to reduce the U.S. influence and control over the region. Besides Morales and Ecuadorian President Rafael Correa, Argentina’s President Néstor Kirchner, Brazilian President Luiz Inácio Lula da Silva, and Nicaraguan President Daniel Ortega, all share Chávez’s belief that Latin America’s social and economic inequalities are rooted in external dependence, and are thus opposed to recent U.S.-led free trade proposals. Peter Hakim, in his early 2006 article in Foreign Affairs, suggested that “relations between the United States and Latin America today are at their lowest point since the end of the Cold War.” I find Hugo Chávez most responsible for this state of affairs.

Outcome

Venezuela’s President Hugo Chávez increased taxes and royalties for oil companies operating in Venezuela, bringing government’s effective take to more than 80 percent. He also changed law so that strategic agreements with foreign companies are now at least 51 percent controlled by the government-owned PdVSA. In the 1990s, Venezuela abandoned its previous policy of restricting oil output to force higher prices, and threw its state-owned oil industry open to investment by IOCs. Under Hugo Chávez, it is moving back, gradually, to re-nationalisation. From now on, IOCs will be minority partners in JVs with PdVSA. Despite this, most IOC executives believe that staying in Venezuela is worthwhile because there are not many other places where they can

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646 For more on Latin America’s movement to petro-nationalism see a forthcoming book by George Philip, Oil and Politics in Latin America: Nationalist Movements and State Companies (Cambridge: Cambridge University Press, 2008).
649 Ecuador, for example, wants a larger revenue share from foreign oil companies and recently approved a new hydrocarbon law that amounts to a unilateral breach of production contracts. For more on oil in Ecuador see Suzana Sawyer, Crude Chronicles: Indigenous Politics, Multinational Oil, and Neoliberalism in Ecuador (Durham, NC, and London: Duke University Press, 2004).
652 Reed and Ixer, “You’re Working For Chavez Now.”
tap such massive reserves. Clearly, Chávez and China are on the winning side, and the U.S. and the IOCs are on the losing side of the bargain. Moreover, as evident from above, Russia, Iran, and India are also reaping benefits of Venezuela’s move away from the U.S.

**Analyses and Conclusions**

Issue linkage is important in analysing Chávez’s policy in contemporary oil industry bargaining in Venezuela. The outcome of oil industry bargaining in Venezuela is primarily influenced by the country’s domestic concerns, but also by Venezuela’s strategic security preferences, China’s domestic and strategic factors, and high oil prices. Venezuela’s international position does not influence the bargaining outcome. While Venezuela lost some credibility in the West, and particularly with the U.S., it gained some with its new partner, China, and other developing states (Brazil, Russia, India, and Iran), and much of the rest of Latin America. These balance each other out. Finally, the United States and the IOCs have practically no influence on the outcome of oil industry bargaining in Venezuela.

Venezuela’s strategic security preferences influence its decision to attempt to balance the hegemonic rule of the United States. The main goal of Venezuela’s foreign policy is to defend the Bolivarian Revolution in Venezuela by opposing globalisation and neoliberal economic policies, and by “explicitly seeking out allies in a bid to check U.S. power and influence in Latin America.” Therefore, its newly established friendship with China could help to serve this purpose. While Chávez is trying to spread the Bolivarian Revolution and thus gain concessions around Latin America by offering cheap energy through initiatives such as Petrocaribe, Petroandina, and Petrosur, the United States fails to support this.

However, this is not Chávez’s main goal. His main objective, maintaining his regime stability, comes from the domestic arena. Thus, the main factor influencing the outcome of oil bargaining in the case of Venezuela is Chávez’s attempt to maintain regime stability. This is the main driving force of Chávez’s policies regarding PdVSA. The re-nationalisation of PdVSA and the new rules of the oil game in Venezuela are all aimed to fill up the government coffers, and strengthen Chávez’s regime. Chávez needs piles of petro-dollars to bribe the population and maintain his rule, and given the history of U.S. intervention in Latin America (Chile, Panama, Nicaragua etc.) he wants to protect his regime from destabilising attempts by the U.S. A Chávez-controlled oil

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653 Ibid.
655 Trinkunas, “What is Really New about Venezuela’s Bolivarian Foreign Policy?”
656 Venezuela is providing up to fifteen Central American and Caribbean nations with crude oil and products under preferential terms in order to buy their political support. The San Jose Accord, originally implemented in 1980 and renewed annually, currently covers the following eleven countries: Barbados, Belize, Costa Rica, El Salvador, Guatemala, Haiti, Honduras, Jamaica, Nicaragua, Panama and the Dominican Republic. Venezuela also supplies Cuba with between 50 and 100,000 bpd on “favorable financing terms,” or the services of thousands of Cuban doctors, under an agreement signed between Chávez and Cuban President Fidel Castro in 2000. See also, “How Big a Threat is Hugo Chávez?” *The Economist*, May 14, 2005, p. 11. According to *Business Week*, Chávez’s Petrocaribe initiative offers 196,000 bpd to 13 countries; see “Chávez’ Oil-Fueled Revolution,” *Business Week*, October 10, 2005, p. 31; and “Using Oil to Spread Revolution,” *The Economist*, July 30, 2005, pp. 37-8. *The Economist* has suggested that Venezuela offers over 300,000 barrels a day at a discount under a variety of concessionary deals. “The World According to Chávez,” *The Economist*, September 30, 2006, p. 49. Petrosur and Petroandina are yet new initiatives to provide cheaper fuel to South America. For more, see Mares and Altamirano, “Venezuela’s PDVSA and World Energy Markets,” pp. 72-6.
industry allows him to spend at will, which is also useful during election season,\textsuperscript{657} evident in his overwhelming victory in December 2006 presidential election.\textsuperscript{657}

There is no viable option the United States can pursue to influence the outcome of bargaining with Venezuela. The United States cannot impose economic sanctions against Venezuela since the latter did not do anything illegal by international norms and rules.\textsuperscript{658} In any case, economic sanctions against Venezuela would be a disastrous policy, especially at the time of high oil prices. Support of Chávez’s opponents would backfire, as it already did in 2002. Decision not to import oil from Venezuela would go against the 2001 National Energy Policy and would result in the U.S. becoming overly reliant on a single region – the Middle East – for its oil imports, which would go against its diversification policy. Hence, the American strategic security, which incorporates energy security, dictates the U.S. to keep Venezuela as one of its major oil suppliers. The only way to do this is to support the presence of American IOCs in Venezuela and of CITGO in the U.S., and to limit the Chinese presence in Latin America. Thus far, while the U.S. has been engaged in the Middle East, domestic reaction to China’s growing ties with Latin America has been muted.

The overall U.S. bargaining position does not have any influence on the outcome of oil industry bargaining in Venezuela, and thus far, “American policymakers have been unable to influence the Chávez government.”\textsuperscript{659} The U.S. can decide to pressure Chávez on human rights issues, or on him collaborating with terrorists in Colombia or Bolivia, but with very little or no effect. Domestic pressure on the official U.S. position also has no effect on oil industry bargaining in Venezuela. Calling Chávez “Venezuela’s Mussolini”, “Castro with oil,” comparing his turn to authoritarianism to that of Hitler, and calling for U.S. special forces to “take out” Chávez, backfires and makes him even more hostile to the U.S. interest,\textsuperscript{660} and fuels the spread of Bolivarian Revolution around Latin America. The conservative circles may even suggest military action taken against Venezuela, but this is an extremely unlikely option to be pursued considering the oil prices and potential international condemnation. The bottom line is that Venezuela can easily find other customers and investors, while it may be extremely hard for the U.S. to find new suppliers of crude oil. In June 2006, the U.S. Government Accountability Office (GAO) reported that any move to replace oil from Venezuela with fuel from other suppliers would take several years and would require a significant increase in production capacity elsewhere in the world.\textsuperscript{661}

The U.S. and other Western IOCs are in similar situation as the U.S. government. Since very few options exist elsewhere, they have no other option but to stay in Venezuela and adhere to the government’s decisions, due to this bargaining power asymmetry. Those who resist the most will fare the worst. According to Michelle Billig, compared to Russia or Nigeria, “Venezuela may start to look more attractive.”\textsuperscript{662} This highlights the lack of options available for the IOCs. The bargaining position of major IOCs is weakened by the rise of resource nationalism in Venezuela. The companies that began 2006 vowing not to give up their contracts have fallen into line with


\textsuperscript{658} See Chapter 3, footnote 123.

\textsuperscript{659} Lapper, “Living with Hugo,” p. 3.


\textsuperscript{662} “Leaving the Door Ajar,” \textit{The Economist}.
the government, with almost no protest, and this speaks volumes about the balance of power between governments and their NOCs, and international investors. By raising taxes and royalties, and reducing IOC stakes to a minority component, Chávez is strengthening the hand of NOCs around the world.

Oil prices play a role in determining the outcome of bargaining in Venezuela’s oil industry. Chávez decided to pursue ‘re-nationalisation’, to improve relationship with OPEC, and to establish oil-based friendship with China at the time when oil prices are high. This means that the American, or Western IOC response, or retaliation, can be very limited since it would result in further rise in oil prices. The outcome may have been different had the oil prices been low, as the U.S. and the IOCs would possess more bargaining power. This highlights the importance of bounded rationality – changes in market conditions – on the outcome of bargaining.

In precisely the same way as they are influencing bargaining for pipelines with Russia, China’s domestic and strategic concerns influence the outcome of oil industry bargaining in Venezuela. Increased oil imports are deemed necessary to feed the growing Chinese economy, healthy growth of which is crucial to maintain regime stability. Venezuela cannot provide China with as much oil as Russia, but its share may be important in China’s attempt to diversify its sources of imported oil as much as possible away from the Middle East, and U.S.-controlled sea-lanes linking the Middle East with East Asia. Unlike the U.S. government, China, together with Russia and many non-Western countries, have nothing against Chávez personally or ideologically, and they support him, albeit tacitly, in his efforts to spread Bolivarian Revolution to the rest of Central and South America.

Relationship with Hypotheses

The case study of Venezuela’s contemporary oil industry bargaining has direct relevance to all of the hypotheses set in Chapter 2. Evidence presented in this case study is supportive of hypothesis one. Due to their weak bargaining power, the IOCs have been on the losing side of their bargain with Venezuela in the current decade and we are witnessing the return of the obsolescing bargain in Venezuela. The evidence is only partially supportive of hypothesis two, as although the interests of the U.S. governments and its IOCs were aligned, the IOCs were not supported by the U.S. government, and thus they lost bargaining power vis-à-vis Venezuelan government. In addition, evidence presented is also supportive of hypothesis three, since the IOCs are losing their bargaining power in Venezuela due to the rise of and interference from the NOCs from oil importing countries, such as China. Evidence only partially supports the hypothesis four, as although China and America’s oil supply security is perceived as threatened when bargaining in Venezuela, only the U.S. government did not emerge victorious from bargaining. Finally, it is not supportive of hypothesis five, as in bargaining with other actors, Venezuela uses oil, explicitly and/or tacitly, and this allows it to earn concessions from the other actors. These primary conclusions will be elaborated on in more detail in Chapter 7, when I discuss my findings in detail.

663 “Chavez Triumphant.”
The focus of this chapter is on bargaining in the American oil industry, by examining two case studies. The first case study deals with bargaining for the acquisition of UNOCAL, an American oil company, and features Chevron, an American IOC, the U.S. Congress, and CNOOC, a Chinese NOC, as the major actors. The second case study looks at bargaining for the future of the Arctic National Wildlife Refuge (ANWR) and it features two opposing coalitions – the Arctic Power and the Alaska Coalition – as the main actors.

Politics clearly ruled over purely economic reasons in determining the outcome of bargaining for UNOCAL. Although CNOOC offered $2 billion more than Chevron for UNOCAL, it did not manage to acquire this company. If it were for purely economic factors, and if the bidding game for UNOCAL was primarily market driven, CNOOC would now be in charge of UNOCAL assets. James Dorn argues, “There is little doubt that CNOOC’s bid would have prevailed if not for congressional interference.” However, in oil industry bargaining, economic factors infrequently dominate politics, and the outcome of UNOCAL bargaining was clearly influenced by the latter, as Congress inserted itself in the middle of the CNOOC-UNOCAL deal. Similarly, politics are likely to determine the outcome of bargaining for the future of ANWR regardless of who wins in the end. Politics – energy dependence on unfriendly overseas regimes – primarily drives the Bush administration to enhance domestic oil supplies. Economically, it would make much more sense to buy oil from the markets and not spend billions of dollars on developing technologically demanding oilfields in Alaska. Domestic politics – the dominance of both the Congress and the Senate – will eventually determine the outcome of this bargaining case.

Introduction to America’s Oil Industry

Three major bargaining episodes loom from the history of America’s oil industry. The first was the early-1900s bargaining over monopoly rights between Standard Oil, which at one point

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controlled 90 percent of the U.S. market and much of the international market as well,\textsuperscript{666} and the rest of the country, in which the former was on the losing end. The second was bargaining over voluntary and mandatory import quotas, which lasted for almost two decades, between 1955 and 1973. Discovery of cheaper, mainly Middle Eastern oil abroad threatened U.S. independent producers, whose production costs were rising. These aggrieved producers pressed the White House and lawmakers in Congress to adopt measures to limit the import of cheaper foreign crude, which was delivered and imported by the majors. Consequently, in 1955 the government imposed ‘voluntary’ restrictions on imports in order to curb the flow of cheap imports and alleviate the adjustment burden on domestic producers. However, since demand for imports continued to surge, on 10 March 1959, President Eisenhower announced the imposition of mandatory quotas on oil imports into the United States – The Mandatory Oil Import Program (MOIP).\textsuperscript{667} Given that after the imposition of mandatory quotas, majors could not bring foreign oil into their own system in the U.S., they had to develop markets and make profits elsewhere in the world, and thus they were not supportive of the MOIP.\textsuperscript{668} The mandatory program taught the majors a bargaining lesson. They may have had the financial resources, they may have had the scale and the expertise, but the independents had the domestic political influence, and it was to them that the senators and congressional representatives from the oil patch responded. The MOIP was finally scraped by Nixon in April 1973 following the peak of U.S. oil production in 1970 and subsequent gasoline shortages in light of rising demand. In general, the MOIP merely postponed rising U.S. dependence on Middle Eastern oil imports, and failed as a security measure, because it stimulated production levels that eroded domestic reserves.\textsuperscript{669}

Finally, between 1970 and 1972 oil companies successfully defeated the environmentalists in their push for construction of the Alaskan oil pipeline. The domestic energy crisis and the recession that followed posed the first major challenge to the environmental movement. The first environmental policy affected by the energy crisis was the construction of the Alaskan oil pipeline.

\textsuperscript{666} Theodore H. Moran, “Managing an Oligopoly of Would-be Sovereigns: The Dynamics of Joint Control and Self-control in the International Oil Industry Past, Present, and Future,” \textit{International Organization}, vol. 41, no. 4, Autumn 1987, p. 579. Ultimately, Rockefeller's great success conflicted with U.S. antitrust laws: in 1911, Standard was forcibly broken into dozens of smaller companies. For an excellent figure showing full deconstruction of Standard Oil Trust between 1900 and today, see Falola and Genova, \textit{The Politics of the Global Oil Industry}, p. 26. For more on the break up of Standard Oil, see Yergin, \textit{The Prize}, pp. 97-110. In a sense, however, Rockefeller's legacy never died. Most of Standard’s corporate shards have since been reconstituted into the handful of giants that until 1971 controlled most of the international oil business; in fact, two Standard spin-offs, Exxon and Mobil, recently merged to form the largest oil company in the world by assets, market value and profits (see “The Forbes Global 2000: The World’s Biggest Companies,” \textit{Forbes}, April 18, 2005). Moreover, the business model Rockefeller pioneered – that of a giant multinational corporation, capable of operating in any market or sector, but dependent for its profits on ever-greater oil production – remains the standard in the energy business (Roberts, \textit{The End of Oil}, pp. 37-8).


\textsuperscript{668} Yergin, \textit{The Prize}, pp. 539-40. The import quotas did achieve their fundamental goal: They provided ample protection for domestic oil production against lower-cost foreign oil, evident in the fact that by 1968, U.S. crude oil output was 29 percent higher than it had been in 1959, the year the mandatory quotas were introduced. Companies, large and small, adapted to mandatory quotas. The majors, despite their initial vociferous criticism of the quotas, eventually came to see the merit in a program that protected the profitability of their own domestic operations, albeit at the expense of their foreign ones. Their adjustment was facilitated by the fact that demand elsewhere was growing with sufficient rapidity to absorb their foreign production.

pipeline. Between 1970 and 1972, environmentalists filed a series of lawsuits that effectively delayed the construction of a pipeline designed to transport oil from the North Slope of Alaska to the West Coast. In opposition to the environmentalists, the lobbying and public relations effort to expedite approval of the Alaska pipeline was primarily led and funded by the oil and natural gas industry. These efforts were supported by the State of Alaska and the Nixon administration. In 1972, the seven oil companies involved in the pipeline construction began to press for legislation to expedite its construction. In response, more than thirty organizations, the majority of the environmental groups, formed the Alaska Public Interest Coalition. The environmentalists argued “the Alaska route would be an environmental disaster” and urged that other routes, including one through Canada, be studied. Furthermore, they contended that there was “an almost total lack of information on the justification for haste.” Following heavy lobbying by the oil companies, in July 1973, the Senate voted to bar further court challenges to the pipeline’s construction on environmental grounds and directed the Secretary of the Interior to issue the necessary authorization for the pipeline construction. Four months later, and after the first oil shock, final action on this legislation was completed by Congress. The environmentalists attributed their defeat to the power of the oil industry and its allies.

The above episodes illustrate the domestic bargaining strength of American oil companies, particularly smaller companies, as in the Standard Oil and MOIP bargaining episodes, and influence they have on American politicians and lawmakers. I established in Chapter 2 (the section on home state-MNC relations) that oil industry in the U.S. spends large amounts of financial resources for lobbying to get political support in Washington. In doing this, and in order to influence agenda-setting in Congress, since 1990, a disproportionate amount of oil industry’s overall ‘lobbying’ contributions went to members of committees dealing with energy issues, and thus, American oil companies have at times been able to exercise considerable influence over U.S. domestic oil policy. For example, despite a lot of pressure from the environmentalists, by securing powerful political allies in the Congress, and by siding with the automotive industry, they have been able to maintain policy status quo concerning climate change, and avoid any substantial investments in alternative or renewable forms of energy and therefore any policy aimed at curbing domestic petroleum consumption. One could argue

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670 Oil firms placed a large number of ads in newspapers in major cities stating the industry’s case. Testifying before Congress on March 27, 1972, Arco’s president, Thornton Bradshaw, whose company owned 28 percent of the pipeline as well as a major share of North Slope exploration rights, stated that the country “can no longer afford continuing delay bringing Alaska oil to the people that need it.” He told the Congress “every day we delay costs us, in terms of the 1980 trade deficit, another $10 million.” Bradshaw promised that, if construction began at once, Alaskan oil could be delivered to the continental United States by 1977. Quoted in Congressional Quarterly Almanac, 1973 (Washington, D.C.: Congressional Quarterly, 1974), p. 598.

671 Vogel, Fluctuating Fortunes, pp. 129-30.

672 Quoted in Congressional Quarterly Almanac, 1973, p. 598.

673 Vogel, Fluctuating Fortunes, p. 130.

674 George Alderson, the legislative director of the Friends of the Earth, and the environmentalist coalition’s coordinator, said: “This is the greatest accumulation of power that ever confronted the environmentalists in a legislative fight.” Another environmentalist observed, “The oil companies put across a wide range of pressure to convince Americans that Alaska oil would be put into their gas tanks.” Faced with a choice between potential ecological damage to a remote wilderness area and a continued shortage of gasoline, the American public chose the former. Both quoted in Congressional Quarterly Almanac, 1973, p. 604.


therefore that in this context, ‘money buys influence’ line of reasoning is plausible and even probable, but not conclusively verified.\footnote{678}

The historical bargaining episodes, which were briefly examined above, also show that the institutional locus of political action on domestic petroleum policy lies in Congress, and the executive branch of the U.S. government possesses precious few tools to affect energy policy at the domestic level.\footnote{679} The failure of the Clinton administration – featuring a decidedly ‘green’ Vice President Al Gore – to enact its environmental agenda is illustrative of this point. While presidential influence may alter a few crucial votes in a strongly divided Congress, comprehensive energy legislation with its far-reaching implications, will generally pass or fail regardless of presidential preferences. Use of the presidential veto can typically block legislation but does not provide the agenda-setting power required to pursue comprehensive energy legislation. This power rests in the plethora of issue overlapping committees and subcommittees, which formulate the legislation that is accepted or rejected by Congress.\footnote{680}

As elaborated in Chapter 2, where I surveyed the relationship between home states and MNCs, the major IOCs’ record has been mixed concerning their influence on the U.S. foreign oil policy as well as domestic oil policy, as more often than not, they did not receive backing from the U.S. government. Although the President possesses crucial ability to frame and act upon U.S. foreign policy agenda, and thus, he is responsible for formulating American foreign oil policy,\footnote{681} the U.S. foreign policy interests are not necessarily identical to, or aligned with, those of the oil industry.

According to BP, in 2005 the United States had 29.3 billion barrels of proved oil reserves, eleventh highest in the world.\footnote{682} These reserves are concentrated overwhelmingly (over 80 percent) in four states: as of 31 December 2003, Texas had 22 percent of total US oil reserves; Louisiana also had 22 percent; Alaska 20 percent; and California 18 percent.\footnote{683} U.S. proven oil reserves have declined by 19.5 percent since 1985, with the largest single-year decline (1.9 billion barrels) occurring in 1998.\footnote{684} With the exception of the early 1980s, the U.S. crude oil production has been in a continuous decline ever since its peak in 1970 (see Table 5.1). During 2005, the United States produced 6.8 million bpd, which was as low as in 1961. Total U.S. oil production in 2005 declined sharply, by around 3.75 million bpd, or 35 percent, from 10.6 million bpd averaged in 1985, and was only 60 percent of its peak value in 1970 (Table 5.1). Regardless of the decline in production, in 2005, the U.S. was still the third largest oil producer in the world.

\begin{table}[h]
\centering
\caption{The U.S. Crude Oil Production and Consumption (Selected Years and 1995-2005)}
\begin{tabular}{|l|l|l|}
\hline
Year & Production & Consumption \\
\hline
1995 & 7.0 & 5.5 \\
1996 & 6.8 & 5.2 \\
1997 & 6.5 & 4.9 \\
1998 & 6.2 & 4.7 \\
1999 & 6.0 & 4.5 \\
2000 & 5.8 & 4.3 \\
2001 & 5.6 & 4.2 \\
2002 & 5.4 & 4.0 \\
2003 & 5.2 & 3.8 \\
2004 & 5.0 & 3.6 \\
2005 & 4.8 & 3.4 \\
\hline
\end{tabular}
\end{table}

\footnote{679}{For example, the oil industry failed to secure its interests on a number of issues such as gasoline composition and federal land-use. Goel, “A Bargain Born of a Paradox,” p. 474 and 478.}
\footnote{680}{Ikenberry, Reasons of State, p. 44.}
\footnote{681}{Goel, “A Bargain Born of a Paradox,” pp. 472-3.}
\footnote{683}{BP Statistical Review of World Energy 2006.}
\footnote{684}{All of these figures include onshore plus Federal and state offshore reserves. “United States Country Analysis Brief,” Energy Information Administration, January 2005, www.eia.doc.gov, [November 24, 2005].}
\footnote{685}{BP Statistical Review of World Energy 2006.}
<table>
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<th>Year</th>
<th>Production (mbpd)</th>
<th>Consumption (mbpd)</th>
<th>Balance (mbpd)</th>
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<tbody>
<tr>
<td>1985</td>
<td>10.580</td>
<td>15.726</td>
<td>-5.146</td>
</tr>
<tr>
<td>1995</td>
<td>8.322</td>
<td>17.725</td>
<td>-9.403</td>
</tr>
<tr>
<td>1996</td>
<td>8.295</td>
<td>18.309</td>
<td>-10.014</td>
</tr>
<tr>
<td>1997</td>
<td>8.267</td>
<td>18.621</td>
<td>-10.354</td>
</tr>
<tr>
<td>1998</td>
<td>8.011</td>
<td>18.917</td>
<td>-10.906</td>
</tr>
<tr>
<td>1999</td>
<td>7.731</td>
<td>19.519</td>
<td>-11.788</td>
</tr>
<tr>
<td>2000</td>
<td>7.733</td>
<td>19.701</td>
<td>-11.968</td>
</tr>
<tr>
<td>2001</td>
<td>7.669</td>
<td>19.649</td>
<td>-11.980</td>
</tr>
<tr>
<td>2002</td>
<td>7.626</td>
<td>19.761</td>
<td>-12.135</td>
</tr>
<tr>
<td>2003</td>
<td>7.400</td>
<td>20.033</td>
<td>-12.633</td>
</tr>
<tr>
<td>2004</td>
<td>7.228</td>
<td>20.732</td>
<td>-13.504</td>
</tr>
</tbody>
</table>

Source: BP Statistical Review of World Energy 2006

The United States is the largest oil consumer in the world, averaging 20.7 million bpd in 2005. This is not surprising, as it currently has some of the world’s lowest taxes on oil products, legacy and remnant of the history of Congress protection of domestic oil industry interests (see above). In 2005, the U.S. averaged total net crude oil and product imports of 13.8 million bpd, representing 67 percent, or over two-thirds of total U.S. oil demand (see Table 5.1), and this makes the United States by far the largest oil importer in the world (see Table 1.1), as its imports quadrupled in the past three and a half decades. Overall, in 2004, the top suppliers of oil to the United States were Canada (2.1 million bpd), Mexico (1.7 million bpd), Saudi Arabia (1.6 million bpd), Venezuela (1.6 million bpd), and Nigeria (1.1 million bpd).

Domestically, the United States has left oil exploration, production, and distribution to private companies. The U.S. is the home of many large oil and gas companies, including remnants of the original Seven Sisters – Exxon Mobil and Chevron – and numerous other medium-to-large companies, such as Conoco Phillips, Valero Energy, Marathon Oil, Occidental Petroleum, Devon Energy, Anadarko Petroleum, Amerada Hess, Burlington Resources, Apache, Sunoco and many more. The main foreign oil presence in the U.S. is that of the two majors, BP and Royal Dutch/Shell, who are active both in downstream and upstream activities, and of refining company CITGO, which is owned by Venezuela’s PdVSA, and which controls nearly 7 percent of U.S. refining capacity.

CASE STUDY 4: Bargaining for UNOCAL – The Rise of Neo-mercantilism

Table 5.2: Goals of Main Actors in Bargaining for UNOCAL

<table>
<thead>
<tr>
<th>Actor</th>
<th>Bargaining Goals</th>
</tr>
</thead>
<tbody>
<tr>
<td>Chevron</td>
<td>Dire need for additional reserves, and therefore acquiring UNOCAL at the lowest price possible</td>
</tr>
<tr>
<td>UNOCAL</td>
<td>Accepting the best bid without domestic and government opposition</td>
</tr>
<tr>
<td>The government of</td>
<td>Purchasing UNOCAL at any price, this involves bidding much</td>
</tr>
</tbody>
</table>

On 4 April 2005, directors of UNOCAL, the twelfth largest U.S. oil company, accepted a $16.5 billion acquisition offer by Chevron, the second largest U.S. oil company. The offer was one quarter in cash and three quarters in Chevron stock. However, on 22 June 2005, CNOOC, the third largest Chinese NOC, made a counteroffer of $18.5 billion in cash, financed in part by low interest rate loans from its state-owned parent company. CNOOC needs overseas fields to complete their mission to double oil production between 2005 and 2010 in order to contribute to meeting China’s long-term oil demand. UNOCAL would have made that objective possible in just one transaction.

However, on 30 June 2005, a nonbinding House Resolution (H.R. 344) recommending presidential review of the CNOOC deal was passed by a vote of 398 to 15. In a letter to President Bush, House Energy and Commerce Committee Chairman Joe Barton declared, “we urge you to protect American national security by ensuring that vital U.S. energy assets are never sold to the Chinese government.” In mid-July 2005, Chevron increased its bid to $17.7 billion, turning up the heat on CNOOC to respond with a higher bid of its own. Although higher, CNOOC’s offer faced “unprecedented political opposition” in Washington, which made it impossible to compete with Chevron by “creating a level of uncertainty that presents an unacceptable risk to our ability to secure this transaction,” finally leading it to withdraw its bid on 2 August 2005, thus leaving it to Chevron to complete the takeover.

UNOCAL was a relatively small player in the U.S. oil industry. Its 2004 American production was barely 57,000 bpd, or 0.8 percent of total U.S. crude oil production and 0.3 percent of total U.S. crude oil consumption. In past, there was no U.S. opposition to PetroChina’s acquisition

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687 25 percent in cash and 75 percent in Chevron’s stock.

688 It is interesting to note that before the purchase the CNOOC (41st largest oil company in the world) was ranked lower than Unocal (34th) in “The Forbes Global 2000”.


690 The logic, as stated in H.R. 344, is simple: (1) Oil and natural gas are “strategic assets critical to national security and the Nation’s economic prosperity.” (2) China is an authoritarian regime “strongly committed to national one-party rule by the Communist Party” and owns about 70 percent of CNOOC’s stock. (3) Subsidised loans will be used to help finance the proposed takeover. (4) CNOOC may whip oil and natural gas directly to China rather than sell it in world energy markets, which “would result in the strategic assets of Unocal Corporation being preferentially allocated to China by the Chinese government.” The “would weaken the ability of the United States to influence the oil and gas supplies of the Nation through companies that must adhere to United States laws.” (5) The acquisition “could provide access to Unocal Corporation’s sensitive dual-use technologies that the United States would otherwise restrict for export to China.” (6) The CNOOC deal therefore threatens, “To impair the national security,” and “the President should initiate immediately a thorough review of the proposed acquisition, merger, or takeover.” Quoted material from “House Resolution 344,” June 30, 2005, http://thomas.loc.gov/cgi-bin/query/D?c109:1:./temp/~c109nZlvEe, [August 10, 2005].


of Indonesian assets of American companies Devon Energy and Amerada Hess Corporation. If considering only these, and no other factors, it makes no sense that CNOOC’s effort aroused intense opposition in Congress, evident in the letter to the Treasury Department, in which 41 Republican and Democrat politicians raised their concerns that Chinese takeover of UNOCAL could compromise national security. In response, the Treasury Secretary John Snow warned that U.S. firms would face increasing difficulty competing with Chinese oil companies for “scarce energy resources.”

Why did mercantilist factors and protectionism rule over liberal rhetoric in the UNOCAL bargaining game? There are four major reasons, which explain this, three of which come from the American side, and one from the Chinese side. Firstly, UNOCAL carried the symbolic value, and U.S. domestic constituents’ opposition to Chinese purchase of the company stemmed from the overall context of Sino-American relations. Secondly, by stopping its acquisition of UNOCAL, Washington attempted to limit Beijing’s emerging political, economic and military power. Some of UNOCAL’s possessions and activities were located in strategically important regions, which are becoming areas of competition between the U.S. and China, and in addition, some U.S. politicians feared that China would remove oil from the markets. Thirdly, skilful lobbying by Chevron clearly influenced the outcome. Finally, CNOOC offer was not strictly commercial, as the bid would not be possible without the help of Chinese government, which was in a quest to ensure secure energy supplies. All of these factors highlight the importance of issue linkage in determining the outcome of UNOCAL bargaining and are examined in more detail in the following section.

**Outcome**

Chevron won the bid as the U.S. Congress passed a resolution expressing national security concerns about the acquisition of UNOCAL by CNOOC, despite the fact that CNOOC’s bid was $2 billion higher than Chevron’s. Thus, evidently, Chevron and the U.S. Government were on the winning side, whereas China and its company, CNOOC, were on the losing side of the bargain. It is unclear where UNOCAL’s shareholders fit, since its board was not the primary determinant of which bid was accepted. The Chevron-UNOCAL merger was completed on 10 August 2005.

**Analyses**

**The United States**

Symbolism was the first reason why political considerations prevailed over the economic ones in bargaining for UNOCAL. Regardless of whether Chinese takeover of a relatively small American oil and gas firm was a risk to U.S. national security, since energy is a strategic commodity, the Chinese purchase of UNOCAL carried a lot of symbolic value. It comes as no surprise that according to a Wall Street Journal poll, besides 96 percent of the Congress, 74 percent of the U.S. public also opposed the deal. American politicians’ and public objections to the deal parallel those heard in the 1970s, when Saudis recycled their petro-dollars by buying into U.S. industries, and in the 1980s, when Japan embarked on a buying spree of American assets. Then, as now,

694 Kennedy, “China May Drill Philippine Oil That Shell, Chevron Rejected.”


696 See Bernard Wysocki, Jr and Jacob M. Schlesinger, “For U.S., China Is a Replay of Japan; Washington Sees Parallels To ‘80s Battles with Tokyo, But Oil Changes the Stakes,” Wall Street Journal, June 27, 2005.
congressional representatives spread misguided fears of excessive foreign control and national-security threats. To illustrate, CNOOC was described as the corporate vehicle of “a Communist dictatorship.”

Every time the public and politicians perceive a non-Western ‘invasion’, despite its liberal rhetoric America gets protectionist. Saudi attempted acquisition in the U.S. steel industry, Japanese acquisition of Rockefeller Centre, followed by the 1988 Exxon-Florio provision to stem Japanese investment in the U.S., communist Chinese attempt to buy UNOCAL, or Dubai Ports’ failed attempt to acquire port facilities in the U.S., all carry enormous symbolic value. Due to historical and/or present hostility towards and fear of the Arabs, the Japanese, or the Chinese, there was, and still is a high degree of public and political opposition to these countries’ acquisitions of important assets in the United States.

Moreover, in order to understand the rationale behind high symbolic value of UNOCAL, the CNOOC-UNOCAL deal must be considered within the broader context of U.S.-China engagement, as bargaining for UNOCAL touched a host of American anxieties about China that had little to do with the merits of the competing offers by the oil companies. The rising U.S. trade deficit with China and Chinese unfair trade practices caused by undervaluation of its currency are regarded by many politicians in the United States as Chinese victory and American loss, and therefore perceived as a threat to U.S. economic and strategic security. Further, China’s rapid rise as an economic power, its military ambitions, and American jobs lost to efficient Chinese manufacturers were among the concerns. Furthermore, Americans were concerned with China’s human right violations, and with the fact that intellectual-property pirates in China were illegally copying American movies and software. Such perceptions point to the fact that American domestic factors clearly helped to determine the outcome of UNOCAL bargaining. Hence, American protectionism and fear, evident in the flurry of anti-China resolution and bills introduced by members of Congress around the time of the CNOOC-UNOCAL bid, was driven by perceptions of a general ‘China threat’, and played a big role in determining the outcome of bargaining for UNOCAL. China, a rising economic and military power, and a potential hegemonic challenger had to be stopped from acquiring a U.S. oil company.

The second reason why political considerations prevailed over economic ones in bargaining for UNOCAL was that since oil is considered a strategic commodity, the U.S. wanted to keep a medium-sized company (UNOCAL) under its control. Before the takeover, UNOCAL produced oil and gas in nine countries outside the United States – Thailand, Vietnam, Indonesia, Bangladesh, Myanmar, The Netherlands, Azerbaijan, Congo, and Brazil, and 70 percent of its oil and gas reserves were located in Asia. Further, UNOCAL was a significant provider of natural gas to South and Southeast Asia (The Philippines, Bangladesh, and Thailand), it owned sensitive undersea mining and deep-water drilling technology, which China was eager to get, and with an 8.9 percent share, was the third largest shareholder in Baku-Tbilisi-Ceyhan (BTC) Pipeline. Thus, if UNOCAL was acquired by CNOOC, the Chinese government would have also gained a

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698 This legislation enables the president to block a foreign acquisition of a U.S. firm that “impairs or threatens to impair” U.S. national security. See Graham, “No Reason to Block the Deal,” p. 24.
share in this recently launched pipeline, which carries oil from the Caspian to the Mediterranean, and then to the export markets in the U.S. and Europe. Thus, China would gain a foothold in a region of utmost strategic importance to the United States, and it could use the pipeline to fuel its own hunger for oil. Additionally, China would further establish its presence in Southeast and South Asia, regions of increased strategic competition between the United States and China, at the American expense, by controlling the production and provision of oil and mostly natural gas in the Philippines, Thailand, Vietnam, Myanmar, Indonesia and Bangladesh. Moreover, by acquiring UNOCAL, which had some possessions in Brazil, China would further establish its energy related activities in South America. It already ventured in several Latin American countries (Venezuela, Argentina, Ecuador, and Brazil) and in Canada. Finally, UNOCAL owned offshore platforms in Cook Inlet, Alaska, and the Gulf of Mexico that are in close proximity to important U.S. national strategic facilities and infrastructure, which were not to become properties of the People’s Republic of China.

All these considerations influenced many American decision-makers, and it became unlikely that the U.S. would give up UNOCAL, and the examples are plentiful. Richard D’Amato, Chairman of U.S.-China Economic and Security Review Commission, told the House Committee on Armed Services on 13 July 2005 that “Chinese takeover of [UNOCAL’s] assets will introduce or increase Chinese political influence in all the regions where UNOCAL assets are located, some of which are of political and strategic importance to the U.S., displacing the influence of an American company with American standards.”703 A growing concern voiced both by the Pentagon’s 2005 Annual Report on the Military Power of the People’s Republic of China, and by Congress was that China’s demand for direct ownership of oil and gas and other “strategic assets” would pose security risks, particularly if China acquired U.S. energy companies. In a congressional hearing on 13 July 2005, Frank Gaffney Jr., President of the Centre for Security Policy, told the House Armed Services Committee that the sale of UNOCAL to CNOOC “would have adverse effects on the economic and national security interests of the United States.” He pointed to “the folly of abetting communist China’s effort to acquire more of the world’s relatively finite energy resources” and warned of “the larger and ominous Chinese strategic plan of which this purchase is emblematic.”704 Former CIA chief R. James Woolsey claimed that it is “naïve” to think that the attempted Chinese takeover of UNOCAL is just a commercial matter, and that it is unrelated to China’s strategy for domination of world energy markets and East, South and Southeast Asia. He also stressed that CNOOC’s proposed acquisition is part of China’s long-term strategy to gain military pre-eminence in the Pacific region and that, were China to succeed, this would be inimical to U.S. interests.705 In fearing that China would take UNOCAL’s oil of the market, Richard D’Amato claimed that since “the Chinese treat energy reserves as assets in the same way a 19th century mercantilist nation-state would,” China’s “goal is to acquire and keep energy reserves around the world and secure delivery to China above and beyond any market considerations.” Thus, “the Chinese practice of hoarding oil would divert those supplies from global market,” and if China soaks up too much of

the world energy reserves, the international market will be increasingly squeezed, what could have a devastating impact on the U.S. economy.\textsuperscript{706}

Although Congress used national security arguments to justify the scrutiny of the proposed CNOOC-UNOCAL deal, the relatively small size of UNOCAL convinced some experts that the security card was just a ploy to tilt the deal in favour of the other suitor, Chevron.\textsuperscript{707} Chevron, the sixth-largest corporation in the U.S., exploited its established presence in Washington in bargaining for UNOCAL. It has a sizeable in-house team, represented by the chairman of the House Committee on Resources, Richard W. Pombo, and outside lobbyists and policy advisers, such as Wayne Berman, chairman of the Federalist Group, who served in George Bush Senior’s administration, and a leading fund-raiser for George W. Bush.\textsuperscript{708} Pombo was the very person responsible for amending House Resolution (H.R. 6) on 26 July 2005, to require that the Department of Energy (DOE), along with the Departments of Defense and Homeland Security, conduct a 120-day study on the economic and security implications of China’s growing demand for energy. An important provision of that amendment was that the White House could not approve the CNOOC offer until 21 days after the DOE study was completed. Hence, by adding as much as 141 days to the takeover process, Congress undermined CNOOC’s incentive to continue the bidding war with Chevron.\textsuperscript{709} Pombo later admitted in an interview, “If we [the Congress] hadn’t put the amendment in the energy bill, they [CNOOC] might have succeeded.”\textsuperscript{710} Further, Washington lawmakers who have expressed opposition to CNOOC’s bid for UNOCAL have received more than $100,000 in campaign contributions from Chevron since 2002, according to the Financial Times, which cited publicly available filings in the US.\textsuperscript{711}

Congressional support for Chevron supports Stephen Krasner’s suggestion that large American corporations involved in raw materials possess substantial political resources which can help them in influencing Congress, and the levers of power in the Congress which helped them prevail, were within the oil industry’s grasp on a number of occasions.\textsuperscript{712}

It is important to note that in reality, and against American politicians’ perceptions, if CNOOC acquired UNOCAL and directly shipped oil to China, instead of buying it on the open market, there would be no net change in the world price of oil, and so the United States would not have been ‘crowded out’. China would buy less oil on the market and there would be more available for other countries to purchase.\textsuperscript{713} In addition, “UNOCAL would not provide China with an ‘oil weapon.’”\textsuperscript{714} In other words, Edward Graham has suggested that there was no reason to block


\textsuperscript{707} Dorn, “U.S.-China Relations,” p. 2.

\textsuperscript{708} Lohr, “Sale Hinges on Lobbyists, not Cash.”


\textsuperscript{710} Quoted in Loretta Ng, “Citing ‘Political Environment’ Cnooc Backs Off Its Bid to Acquire Unocal,” New York Sun, August 3, 2005.

\textsuperscript{711} “US Lawmakers Meddle in CNOOC’s Unocal Bid,” The Financial Times, July 6, 2005.

\textsuperscript{712} For example, in the Middle East oil policy in the 1940s. See Krasner, Defending the National Interest, pp. 74, 156, 189, 198-9, 213-5.

\textsuperscript{713} Bergsten, et al, China: The Balance Sheet, pp. 112-3.

the deal.\textsuperscript{715} When passing the H.R. 344, Congress ignored the obvious reality. In relation to Chinese acquisition of sensitive drilling technology through UNOCAL, Jerry Taylor said, “there is nothing UNOCAL has in the oil sector that isn’t available through contractors, or private vendors, or whatnot … there’s nothing proprietary there.”\textsuperscript{716} However, these obvious facts played no role in the bargaining process.

\textbf{China}

The fourth and the final reason why political considerations dominated the economic ones in bargaining for UNOCAL stems from the Chinese strategic security. Since most of China’s oil imports come by sea, and are vulnerable to a U.S. Navy blockade, Beijing is seeking to diversify its sources away from the Middle East to Russia, Central Asia and Pacific. UNOCAL’s possessions in Asia would serve this purpose, albeit to a limited, but nevertheless important extent, and would put China in control of additional 1.7 billion barrels of oil equivalent, control of which in China is perceived as important if there is a real shortage on the markets.

While trying to portray their attempted purchase of UNOCAL as purely economic, the Chinese side launched a public offensive against the U.S. government, attacking the latter of mixing politics with an economic issue. For example, Liu Jianchao, a spokesperson for China’s Foreign Ministry, claimed that in bargaining for UNOCAL “commercial activities should not be interfered in or disturbed by political elements,” and that “we [Chinese Foreign Ministry] demand that the U.S. Congress correct its mistaken ways of politicising economic and trade issues, and stop interfering in the normal commercial exchanges.” In addition, CNOOC Chairman Fu Chengyu stated, “the bid is simply a normal business activity based on the principles of the free market.”\textsuperscript{717}

However, the Chinese side failed to keep activities strictly commercial in the first place. Although some have suggested that China’s oil companies are not “the puppets of the government” whose “corporate interests are not always in line with those of the government or the Communist Party,”\textsuperscript{718} it is more than likely that “if CNOOC were truly a private [and independent] firm, Congress would not have been so concerned.”\textsuperscript{719} CNOOC, 70 percent government owned, planned to pay for UNOCAL by using substantial loans ($7 billion) from its parent company (also called CNOOC), $6 billion from a major Chinese government-owned bank (Industrial and Commercial Bank of China), and only $3 billion from its financial advisers (JP Morgan and Goldman Sachs). The U.S. Treasury Department was not impressed by this plan, which was clearly driven by Chinese government policy. Further evidence of this is that the $7 billion loan from the government-owned parent company would come with only 3.6 percent interest, lower than 4.2 percent, which U.S. government treasury bonds yielded at the time and interest-free loan from the government-owned bank.

In a statement that portrayed the American sentiment regarding the attempted Chinese takeover of UNOCAL, Chevron vice chairman Peter Robertson said that CNOOC “clearly isn’t a


\textsuperscript{716} Excerpted from the July 13, 2005, audiotapes of the House Armed Services Committee Hearings on the CNOOC-UNOCAL Deal. Edward Graham agrees with Taylor’s assessment, and argues, “Any technological expertise held by Unocal is readily available to China from many other sources.” Graham, ‘No Reason to Block the Deal,” p. 25.


\textsuperscript{719} Dorn, “U.S.-China Relations,” p. 8.
commercial company. In my opinion, that’s not right… We think it’s a national energy-security issue. We’re clearly up against the Chinese government.”

In yet another statement, Richard D’Amato told the House Committee on Armed Services on 13 July 2005 that CNOOC’s takeover bid for UNOCAL “gives every appearance of being an effort by the Chinese government to take over a private American oil company.” It is clear that CNOOC’s access to the Chinese government and to cheap financing which gave it an unfair advantage vis-à-vis Chevron, did not sit well with American politicians and the public.

Thus, indirectly, by allowing CNOOC to get cheap government money for its attempted acquisition of UNOCAL, Chinese strategic security concerns influenced the bargaining outcome. The Americans perceived this move as the attempt of the Chinese government, and not of a private company, to buy strategic American assets, with domestic backlash against the Chinese an unavoidable outcome. Senator Byron Dorgan, who drafted anti-CNOOC legislation, objected to the Chinese move on fair-trade grounds. The Chinese government, he says, would not allow an American company to buy a Chinese oil company. “So why on earth should they be able to buy an American oil company?”

What are some possible consequences of unsuccessful Chinese bid for UNOCAL? Consequences may be felt in the overall Sino-American bargaining relationship, working against U.S. interests. China may start buying European Airbus airplanes rather than American Boeings. It may offer more diplomatic and other help to Iran in building up its nuclear capacity. It may stop recycling its trade surplus by purchasing the U.S. treasury bonds, and therefore stop financing Bush’s ‘economic experiment’ and low interest rates. All this is uncertain. However, China will certainly continue getting more assertive in its attempt to secure sufficient energy in order to fuel its economic growth. For example, only days after UNOCAL withdrawal, CNPC acquired PetroKazakhstan for $4.2 billion, beating India’s state-owned Oil & Natural Gas Corp. (ONGC) by $600 million, and offering 21.1 percent premium on the price of PetroKazakhstan’s shares. This acquisition was regarded as “revenge on Washington for the blocking of the China acquisition of UNOCAL,” as U.S. IOCs had previously made major efforts to lock up Kazakhstan oil.

Further, China is likely to turn its attention to other independent American oil companies, such as Murphy Oil. The bottom-line is that the United States and China are competing for global hegemony. In order to secure adequate energy supplies and in line with this competition, in oil industry bargaining, political considerations are likely to continue to dominate economic considerations. In recent years, Chinese oil demand growth has been staggering (see Table 3.5). This rise in demand was largely met by increasing imports. In order to feed its growing hunger for imported oil, China is very likely to get more assertive in securing oil and gas supplies from the Middle East, Russia, Central Asia, South America and Africa, regions that provide the U.S. with a large share of its own imported oil. Against U.S. wishes, China will also continue to look

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722 Lohr, “Who’s Afraid of China Inc.?”
723 Ibid. In 2004, China had a record $162 billion trade surplus with the United States.
725 William F. Engdahl, “China Lays Down Gauntlet in Energy War,” Asia Times, December 21, 2005. Exxon Mobil was charged with bribery of Kazakh officials to win a presence in the Kazakh oil business, and a senior Mobil executive was later jailed on U.S. tax evasion in New York tied to the Kazakh bribery payments.
for energy in rogue states, and states unfriendly to the U.S., such as Venezuela, Iran, Sudan, Syria or Myanmar.

One important fact can be learnt from bargaining from UNOCAL. IOCs can benefit from public and political support at home. Chevron’s bid for UNOCAL was supported by heavy lobbying in Congress. There was barely a peep in the U.S. when BP, a foreign oil company, bought both Amoco and Arco. Thus, to an extent, the fight for UNOCAL was about deep anxieties over China’s long-term oil and other ambitions, and the way in which these will affect the future of Big Oil. IOCs face a harsh landscape worldwide, as government-backed NOCs elbow their way into the industry. As shown in Chapters 3 and 4, these, and other IOCs are struggling in competition for reserves and concessions with NOCs in both Russia and Venezuela, and have to be helped to compete. If Western governments support their IOCs, as the U.S. government did in the case of UNOCAL, and their interests are aligned, Big Oil’s bargaining power may increase. The case of UNOCAL is reminiscent of another past reaction of an IOC’s home government, when in 1987/88, KIO, a part of the Kuwait Investment Authority, bought a 23 percent stake in BP. In response, BP successfully appealed to the British government to intervene, as its board members argued that what was ostensibly a portfolio transaction by KIO was in fact a veiled attempt by KPC to take over BP. With their inability to secure badly needed oil reserves in non-Western countries, such as Russia and Venezuela where their home governments could not do much to help them (see Chapters 3 and 4), IOCs are in dire need of more help from their home governments, at least on their home turf. If such help does not arrive, they will likely engage in further industry consolidation, in some way possibly a full swing back to the almost-monopoly days of Standard Oil as effects of the antitrust decision of 1911 may continue to be negated one company at the time. Alternatively, they risk being bought by a Chinese company, as some have predicted that in future, driven by rising demand for oil imports, many foreign assets will inevitably be swallowed up by Chinese interests.

Conclusion

American and Chinese strategic security concerns and the U.S. domestic bargaining factors influenced the outcome of bargaining for UNOCAL. Since China is on its way to becoming an economic (and military) superpower, as perceived from Woolsey’s and Gaffney’s statements, it is considered strategically important for the United States to limit the growth of China and preserve its world hegemony. Symbolism and the overall ‘China threat’ perception in the U.S. resulted in much negative publicity surrounding CNOOC’s UNOCAL takeover bid, and when considered together with successful lobbying by Chevron in the U.S. Congress, CNOOC had no choice but to pull out. Finally, the fact that CNOOC is owned by the Chinese government, which for its own strategic security reasons adopted a mercantilist approach to the oil markets in recent years, made the Chinese bid for UNOCAL perceived as highly political, and both the U.S. public and politicians wanted to prevent it from materialising.

Besides Chevron’s acquisition of Unocal, Conoco Phillips spent nearly $36bn to acquire US gas producer Burlington Resources. This purchase was said to be motivated, at least in part, by a desire to rebalance its upstream portfolio, which is heavily tilted towards Venezuela, where 10 percent of the company’s upstream capital is invested. “Chavez Triumphant.”
Relationship with Hypotheses

The case study of bargaining for UNOCAL has direct relevance to two of the hypotheses set in Chapter 2. Evidence presented in this case study is supportive of hypothesis two, since as the interests of Chevron and the U.S. Government were aligned, the U.S. Government supported Chevron in bargaining with CNOOC. This support resulted in bargaining success for Chevron. Evidence is not supportive of hypothesis four, since the U.S. government’s perception of threat to its oil supply security resulted in its bargaining success, as it heavily supported Chevron against the Chinese takeover of a strategic asset. For more discussion, please refer to Chapter 7.

CASE STUDY 5: Bargaining for the Future of Arctic National Wildlife Refuge (ANWR) – Oil versus Environment

The political conflict over ANWR centres on the question of whether to approve energy development there, or whether to continue to prohibit development in order to protect the area’s biological, recreational, and subsistence values. While ANWR is rich in oil potential, it is also rich in flora and fauna. Although its development has been debated for decades, sharp increases in oil prices between 2004 and 2006, and the 2001 terrorist attacks against the U.S. have intensified the debate and bargaining over the issue. Current law prohibits oil and gas leasing in the refuge. Below, after introducing the main actors in this bargaining case, I will briefly outline the historical background before engaging in the analyses of recent events.

Bargaining over the rights to drill in the ANWR serves as a perfect example of polarised visions between neoconservatives and progressives in the American political landscape. The pro-oil big business, Republican-led, neoconservative attempt to develop the Arctic Refuge is led by the politicians of the Alaska State delegation, in conjunction with its political allies in the Bush-Cheney administration, and supported by Arctic Power, the primary lobbying organisation for the state of Alaska, the Alaska congressional delegation, and the oil companies. On the other side, the Alaska Coalition consists of many environmental, indigenous and religious groups, and many Democrat Senators support them in opposition to drilling in the ANWR (see Table 5.3 for their bargaining goals).

Table 5.3: Goals of Main Actors in Bargaining for the Future of ANWR

<table>
<thead>
<tr>
<th>Actor</th>
<th>Bargaining Goals</th>
</tr>
</thead>
<tbody>
<tr>
<td>The U.S. government</td>
<td>Emphasising energy independence and therefore opening any</td>
</tr>
<tr>
<td>(particularly the Bush</td>
<td>domestic reserves for drilling</td>
</tr>
<tr>
<td>administration)</td>
<td></td>
</tr>
<tr>
<td>U.S. Senate/Congress</td>
<td>Dependable on which party has the majority: Republicans (pro-drilling);</td>
</tr>
<tr>
<td></td>
<td>Democrats (anti-drilling)</td>
</tr>
<tr>
<td>The Alaskan government</td>
<td>As it receives much of its budget from oil, it definitely supports</td>
</tr>
<tr>
<td></td>
<td>drilling in ANWR</td>
</tr>
<tr>
<td>Oil companies</td>
<td>Clearly supportive of drilling as it would give them much needed additional</td>
</tr>
<tr>
<td></td>
<td>reserves</td>
</tr>
<tr>
<td>Anti-drilling activists (“Alaska Coalition”)</td>
<td>Utterly opposed to drilling in the ANWR for various interests</td>
</tr>
</tbody>
</table>

Development advocates argue that ANWR oil would reduce U.S. exposure to Middle Eastern supplies; lower oil prices; extend the economic life of the Trans Alaska Pipeline; and create jobs

Standlea, Oil, Globalization, and the War for the Arctic Refuge, pp. 16-7.
in Alaska and elsewhere in the United States. They maintain that ANWR oil could be developed with minimal environmental harm, and that the footprint of development could be limited to a total of 8 km². Opponents argue that intrusion on such a remarkable ecosystem cannot be justified on any terms; that economically recoverable oil found would provide little energy security and could be replaced by cost-effective alternatives, including conservation; and that job claims are exaggerated. They maintain that development’s footprints would have a greater impact than is implied by a limit on total acreage. The high profile fight over U.S. congressional votes on whether or not to open the ANWR to oil drilling started in the late 1980s, continuing into the 1990s until the present day.

The 1980 Alaska National Interest Lands Conservation Act (ANILCA) expanded ANWR from 36,400 km² to 76,900 km², and designated around 32,300 km² as wilderness. Congress specifically left open the question of management of a 6,000-km² Arctic Coastal Plain area of ANWR because of the likelihood that it contains significant oil and gas resources. Section 1002 of the Act directed the Department of the Interior (DOI) to conduct geological and biological studies of the Arctic Coastal Plain, 'the 1002 Area', and to provide Congress with the results of those studies with recommendations on future management of the area. Section 1003 of the Act prohibited leasing of the 1002 Area until authorised by an act of Congress.

In 1987, after more than five years of biological baseline studies, surface geological studies, and two seasons of seismic exploration surveys, the DOI recommended to Congress that the 1002 Area be leased for oil and gas exploration and production in an “environmentally sensitive manner.” In 1988, the Natural Resources Defense Council, the trustees for Alaska, and the National Wildlife Federation issued their own report challenging the DOI findings. In 1989, the pendulum of influence swung towards the environmentalists, following the catastrophic oil spillage from Exxon Valdez and thus, in 1991, the provision to open the ANWR to development was dropped from the National Energy Policy Act. In 1995, both the Senate and the House passed legislation containing a provision to authorise leasing in the 1002 Area, but the legislation was vetoed by President Clinton in December 1995, after intense lobbying by the environmentalists.

In May 1998, the U.S. Geological Survey (USGS) issued revised estimates of oil and gas resources in the 1002 Area. The 1998 USGS assessment showed an overall increase in estimated oil resources when compared to all previous government estimates. The estimate reaffirmed the

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732 For more on history of politics of ANWR see David M. Standlea, Oil, Globalization, and the War for the Arctic Refuge (Albany: State University of New York Press, 2006), Chapter 2.


738 Rutledge, Addicted to Oil, p. 70.

739 Ibid. p. 71.
1002 Area’s potential as the single most promising prospect in the United States. The total quantity of recoverable oil within this entire assessment area is estimated between 5.7 and 16 billion barrels, with a mean value of 10.4 billion barrels. Peak production from ANWR, according to the U.S. Government sources, could be between 1 and 1.35 million bpd, and would account for approximately a quarter of all U.S. oil production, but not much more than five percent of U.S. consumption. While it is undoubted that the ANWR holds enormous untapped reserves, drilling and producing oil in deep ice-covered waters, thousands of kilometres from any tanker port, would pose enormous technical challenges. Special equipment and highly trained crews would have to be brought in and protected in a harsh environment. Thousands of engineering and technical hurdles would have to be overcome simply to bring the oil to the surface, to say nothing of building pipelines to get oil to the market.

Since the Arctic is among the more fragile ecosystems on the planet, environmental groups have been willing to fight hard to protect it. For nearly twenty years of debate over opening the ANWR to oil development, they have effectively kept oil companies from tapping into a reserve that lies beneath the ANWR, despite decades of well-financed oil industry lobbying. However, in Bush administration’s effort to increase the U.S. domestic energy supplies, outlined in 2001 National Energy Policy, America would rediscover its supply-side roots, as it did in the 1950s and 1960s. Oil companies would be encouraged to tap new domestic reserves – including those in the ANWR. However, import quotas would be impossible this time. Bush administration’s long-standing drive for increased domestic oil production, most notably in the ANWR, aims to increase America’s energy independence and reduce its reliance on foreign oil, which constitutes approximately two-thirds of its oil consumption (see Table 5.1). Its focus is on security of supply, rather than security from the economic and environmental impact of demand.

In May 2001, the National Energy Policy report asserted that: “Measures to enhance energy security … must begin at home … The first step towards a sound international energy policy is to use our own capability to produce, process and transport energy resources we need.” Five months later, the Interior Secretary Gale A. Norton, announcing the start-up of a controversial new oilfield in Alaska’s Beaufort Sea – the Northstar field operated by BP – declared, “In the aftermath of the 11 September terrorist attacks, Americans charged our Government to strengthen national security. This is a positive step in that direction.” The Northstar project had been strongly opposed by US environmentalists and Norton’s declaration demonstrated a new willingness to ride roughshod over them. Bush and his team ‘kicked sand’ in the faces of the

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742 Roberts, The End of Oil, p. 64.

743 For negative impacts of oil on environment in general, see Falola and Genova, The Politics of the Global Oil Industry, chapter 6.

744 Roberts, The End of Oil, p. 64.

745 A book by Steve A. Yetiv, Crude Awakenings: Global Oil Security and American Foreign Policy (Ithaca, NY: Cornell University Press, 2004), is an example of such a vision of energy security. Yetiv casts U.S. intervention in aid of supply security as beneficial yet minimises the impact of its refusal to intervene on the issue of global climate change.


domestic supporters of the Kyoto agreement, which aimed to limit greenhouse gases, and opening up the ANWR for drilling was next on the agenda.\textsuperscript{748}

In what was to be “environmentally responsible energy development,”\textsuperscript{749} the 2001 \textit{National Energy Policy} recommended opening up the ANWR to oil companies for drilling. It is argued:

Technological improvements over the past 40 years have dramatically reduced industry’s footprint on the tundra, minimised waste produced, and protected the land for resident and migratory wildlife. These advances include the use of ice roads and drilling pads, low-impact exploration activities, and extended reach and through-tubing rotary drilling. These technologies have significantly reduced the size of production-related facilities … [to] no more than 2,000 acres [8 km\textsuperscript{2}] … if the 1002 Area of ANWR is developed.\textsuperscript{750}

Thus, the National Energy Policy Development (NEPD) Group, headed by the Vice-President Dick Cheney and the Secretary of State Colin Powell, recommended that the President direct the Secretary of the Interior to work with Congress to authorise exploration and, if resources are discovered, development of the 1002 Area of ANWR. Further, the NEPD Group suggested that Congress should require the use of the best available technology and should require that activities will result in no significant adverse impact to the surrounding environment.\textsuperscript{751} Finally, the Group suggested the use of an estimated \$1.2 billion of bid bonuses from the environmentally responsible leasing of ANWR for funding research into alternative and renewable energy resources, including wind, solar, geothermal and biomass.\textsuperscript{752}

While Cheney’s NEPD Group was getting to work on its Report to the President in 2001, pressure to open up Area 1002 of the ANWR began to build, and since, the move to allow oil exploration generated a tremendous amount of controversy, pitting environmental and energy conservationists against the oil industry and the government. The campaign to open up the ANWR was led by Arctic Power, a lobbying organisation which was created in the 1990s by the Alaskan state and oil companies, “with the express intention to serve as a lobby group to open up the Arctic Refuge to drilling.”\textsuperscript{753} Arctic Power is publicly funded by the oil companies, such as Exxon Mobil, BP, Conoco Philips and Chevron,\textsuperscript{754} with the interest of exploring and producing in the ANWR, as they need to get their hands on any oil reserves, regardless of potential profitability,\textsuperscript{755} and State Government of Alaska,\textsuperscript{756} and a number of individuals, such as Alaska’s politicians, Governor Frank Murkowski and Senators Lisa Murkowski, Ted Stevens and Don Young.\textsuperscript{757} Alaska had done well out of oil development, at least in the material sense. For many years, a strict royalty and taxation regime had channelled considerable wealth to individual Alaskans. Thus, Alaska’s government and politicians are leading proponents of oil exploration in ANWR, as oil provides 80 percent of the state’s unrestricted general revenues, which helps the

\textsuperscript{748} Rutledge, \textit{Addicted to Oil}, p. 71.
\textsuperscript{750} Ibid. ch. 5, p. 9.
\textsuperscript{751} Ibid. ch. 5, p. 10.
\textsuperscript{752} Ibid. ch. 6, p. 17.
\textsuperscript{753} Standlea, \textit{Oil, Globalization, and the War for the Arctic Refuge}, p. 74.
\textsuperscript{754} Nelson D. Schwartz, “The Biggest Company in America is also a Big Target,” \textit{Fortune}, April 17, 2006, p. 54.
\textsuperscript{755} This is the author’s opinion, and is not expressed publicly, as the oil companies remain publicly neutral about drilling in the ANWR, not to hurt their public image, and tend to press for their cause through the Arctic Power and the State of Alaska, which is controlled by the oil industry. However, David Standlea (\textit{Oil, Globalization, and the War for the Arctic Refuge}, p. 51) argues that if the ANWR were opened for drilling, then the oil companies would proceed to drill and make a profit.
\textsuperscript{756} According to Standlea, “Arctic Power was created explicitly and formally as a nongovernmental organisation designed solely to lobby the U.S. Congress to open up the Arctic Refuge for drilling.” Ibid, p. xiv.
\textsuperscript{757} For more on their involvement, see ibid, pp. 60-5.
state maintain one of the lowest tax rates in the United States. The drilling campaign was also supported by The Heritage Foundation, a public policy research institute whose stated mission is to formulate and promote conservative public policies, and which has had a significant impact on the domestic and foreign policies of the U.S. government.\textsuperscript{758}

In February 2001, Republican Senator Frank Murkowski, then Senator for Alaska and chairman of the Senate Energy and Natural Resources Committee, introduced his National Energy Security Act 2001. Title V of this bill outlined a program for the development of oil and gas resources thought to be present under Area 1002 of ANWR, calling it “the starting point for what will be an important debate during this session of the 107th Congress.” Introducing his bill, Murkowski announced:

Today is the first step in ending America’s dependence on other nations to power our progress… Each day more than 8 million barrels of crude oil come from foreign shores. That is a dangerous strategy by anyone’s measure. This bill spells out a national energy strategy with a critical goal – to finally reduce to 50 percent the amount of oil we import.\textsuperscript{759}

In October 2001, Murkowski and Senator Jim Inhofe from Oklahoma tried to attach a drilling provision to a massive $345 billion defence bill, immediately following the World Trade Centre attack. Murkowski and other Republicans tried to convince senators that opening the refuge was now a matter of national energy security.\textsuperscript{760} A variety of conservative organisations lined up behind Murkowski and Arctic Power, arguing that oil from the ANWR would allegedly replace oil imported from Iraq and elsewhere in the Middle East.\textsuperscript{761} Arctic Power claimed that the ANWR’s coastal plain contained, “from 9 billion to 16 billion barrels of recoverable oil,”\textsuperscript{762} what corresponded relatively well with USGS estimate of 5.7 to 16 billion barrels of recoverable oil. While 16 or even 10.4 billion barrels of oil would be a remarkable addition to America’s reserves of 29.4 billion barrels, the Senate Majority Leader, Democrat Tom Daschle managed to keep the ANWR provision out of the defence bill.\textsuperscript{763}

In the meantime, the environmental, indigenous (Gwich’in), and religious communities are involved in the battle from the anti-drilling perspective. According to David Standlea, the Alaska Coalition, which is fighting the oil development in the Arctic Refuge, is “an extremely large and complex mix of organisations and interests representing an array of overlapping and diverging philosophical positions, though bound by a common denominator of political purpose and tactics.”\textsuperscript{764} The fact that over 600 groups make up the Alaska Coalition illustrates the complexity of this group. Today, the Alaska Coalition is one of the most influential alliances of conservation and indigenous groups in the United States.\textsuperscript{765} In addition, although they are not part of the Alaska Coalition, Senators Tom Daschle, Joe Lieberman, John Kerry and Richard Gephardt are main Democrat opponents to drilling in the ANWR. In order not to become lost in the plethora of details due to the complexity of this group it is imperative to keep foremost in mind only the major ideological platform inherent in the Alaska Coalition and its supporters. Regardless of other groups, it is important to note that the environmentalists “have been running the

\textsuperscript{758} For example, see Charli E. Coon, “Tapping Oil Reserves In A Small Part of ANWR: Environmentally Sound, Energy Wise,” The Heritage Foundation, August 1, 2001; and Ben Lieberman, “Congress Should Let ANWR’s Oil Flow to U.S. Customers,” The Heritage Foundation, May 24, 2006.


\textsuperscript{760} Standlea, \textit{Oil, Globalization, and the War for the Arctic Refuge}, p. 66.

\textsuperscript{761} Rutledge, \textit{Addicted to Oil}, pp. 76-7.

\textsuperscript{762} Ibid, p. 76.


\textsuperscript{764} Standlea, \textit{Oil, Globalization, and the War for the Arctic Refuge}, p. xiv.

\textsuperscript{765} Ibid, p. 29.
campaign, and they have the power” within the Alaska Coalition, while “the Gwich’in have symbolic power.” Therefore, the environmentalists and the indigenous activists are taken as representative of the Alaska Coalition’s major ideological platform and their arguments are examined below.

This crucial relationship in the Alaskan Coalition between the environmentalists and the Gwich’in Athabascan, was established by the Arctic Refuge campaign due to a convergence of values. Both sides capitalise on the need to save the wildlife, particularly the porcupine caribou herd. While the environmental preservationist community sought the protection of wilderness values, wildlife, and federal public lands, the Gwich’in found an overlap of value with the environmentalists because of wilderness and wildlife, of course, but because of very different reasons. According to David Standlea, the Gwich’in are fighting “for nothing less than cultural survival, which includes subsistence rights to continue to hunt caribou, the animal with which they spiritually identify.” Gwich’in, unlike the Inupiat Eskimos of Kaktovik, refused to become co-opted by the oil industry, and remained committed to their own lifestyle. While the ANWR is a federally managed area of land contested by oil companies, state and federal government, and environmentalists, to the Gwich’in it is a sacred place, where their caribou give birth and nurse the young in the summer. The Gwich’in call themselves the ‘caribou people’, and they have a spiritual connection to the caribou, the animal upon which they have depended for subsistence for hundreds of generations. In addition, the land is considered very important to the Gwich’in, as they consider it as their heritage and their way of life.

The environmentalists, who are the major group within the Alaska Coalition, remind us not to forget that ANWR is a wildlife refuge, and that any large-scale exploration and drilling operations in the area could have a serious impact on the wildlife and wilderness in the region. Although drillers are required to file an environmental impact statement, environmentalists believe that such documents are often inadequate and do not provide sufficient information about the impacts that oil and gas exploration and development will have on an area. According to the U.S. government’s Fish and Wildlife Service (FWS), ANWR is the country’s finest example of an intact, naturally functioning community of arctic and sub-arctic ecosystems, as well as being that largest unit in America’s National Wildlife Refuge System. Such a broad spectrum of diverse habitats occurring within a single protected unit is, according to the FWS, “unparalleled in North America, and perhaps in the entire circumpolar north.” Indeed, the completeness and proximity of a number of arctic and sub-arctic ecological zones in the ANWR provides for greater plant and animal diversity than in any other similar-sized land area on Alaska’s North Slope.

Area 1002 of the ANWR, the area explicitly cited for oil development in Cheney’s NEP report, constitutes only 8 percent of the total ANWR area but includes most of the Refuge’s coastal plains and foothills. It is a 160 km-long belt of tundra, compressed between the mountains of the Brooks Range and the Beaufort Sea and stretching between 30 and 60 kilometres inland. Nevertheless, Area 1002 is critically important to the ecological integrity of the ANWR as a

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766 Ibid, p. 103.
767 For more on the Gwich’in, see Standlea, Oil, Globalization, and the War for the Arctic Refuge, Chapter 7.
768 Ibid, p. 102.
769 Ibid, p. 113.
772 Rutledge, Addicted to Oil, p. 72.
whole. It provides essential habitats for numerous internationally important species such as the 129,000 strong porcupine caribou herd, grizzly bears, arctic fox, wolves, musk oxen, snow geese, and polar bears. In addition, besides snow geese, some 135 other species of birds are known to use the 1002 Area. Many of these species are protected by international treaties and agreements.

Some analysts have argued that Prudhoe Bay area offers a stark example of what drilling would mean to Area 1002. BP-owned and operated Prudhoe Bay oil-producing industrial complex, located approximately 100 km to the west of Area 1002, extends across a 2,500-km² region, which is continually expanding as new oilfields are developed. Linking the North Slope oilfields to the port of Valdez, on Alaska’s southern coast is the 1,300 km Trans-Alaska Pipeline System (TAPS). According to the National Resources Defense Council (NRDC), a major opponent of oil drilling in the ANWR describes Prudhoe Bay as:

A gargantuan oil complex that has turned 1,000 square miles of fragile tundra into a sprawling industrial zone containing 1,500 miles of roads and pipelines, 1,400 producing wells and 3 jetports … a landscape defaced by mountains of sewage, sludge, scrap metal, garbage and more than 60 contaminated waste sites that contain – an often leak – acids, lead, pesticides, solvents and diesel fuel.

According to a study of the impact of oil development in the area, during recent years there has been about one spill a day at Prudhoe Bay. The Prudhoe Bay oilfields and TAPS have caused an average of 423 spills annually on the North Slope between 1996 and 2002. In an attempt to ensure renewal of the TAPS rights-of-way, authors of the 2001 NEP claim that ever since the beginning of operations in 1977, only 0.00014 percent of the total amount of more than 13 billion barrels of oil transported from Alaska’s North Slope to the Port of Valdez has been spilled. These 0.00014 percent, however, translates to 207 barrels or 28.4 tons of oil spilled per day, every single day. Roughly, 40 different substances from acid to waste oil are spilled during routine operations. In addition, Prudhoe Bay is a major source of air pollution and greenhouse gas emissions. In March 2006, while the Senate was busy passing a budget amendment in support of opening the ANWR to drilling, Prudhoe Bay faced the largest ever spill to hit Alaska’s North Slope, as 760,000 litres of crude escaped. In August 2006, BP closed the Prudhoe Bay oilfield due to a leak caused by corrosion on an oil transit line. The TAPS was to be closed until 26 km of this ageing pipeline have been inspected and repaired. The bottom-line is that oil companies, which are focused on their economic gains, cannot be trusted to protect Alaska’s fragile environment.

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773 Ibid. For more information on biological resources of the 1002 area, see Corn, “Arctic National Wildlife Refuge: Background and Issues.”
778 The oil industry on Alaska’s North Slope annually emits approximately 56,427 tons of oxides of nitrogen, which contributes to smog and acid rain and North Slope oil facilities release roughly 24,000-114,000 tons of methane, a greenhouse gas. Pamela A. Miller, The Impact of Oil Development on Prudhoe Bay, http://arcticcircle.uconn.edu/ANWR/arcticconnections.htm (November 20, 2005).
In fact, the environmentalists argue that the potential for ecological mayhem is even stronger in the ANWR. This is because studies carried out by the USGS have indicated that unlike Prudhoe Bay, where one massive super-giant field was discovered, it is more likely that oil in the ANWR is scattered across the coastal plain in more than 30 smaller deposits, in complex geological formations. Consequently, development in the 1002 Area would probably require a large number of small production sites spread all across the Refuge landscape, requiring a vast network of roads and pipelines that would fragment the animal habitats and cause major disturbance to the wildlife. The general categories of environmental damage that would be the likely consequences of oil exploration, development and production in the ANWR coastal plain have been listed in detail by the FWS, and their study shows that the area’s wildlife would suffer the most damaging effects.

Bargaining for opening the ANWR for drilling has been an ongoing affair in American politics in recent years. The U.S. House of Representatives (Congress) repeatedly approved drilling in the Refuge, usually as part of broad energy legislation, but the Senate has been unable to overcome Democrat-lead filibusters, which if initiated, later require 60 percent of senators to vote in favour of drilling. This has occurred in both March 2002 and March 2003. In March 2004, the Congress passed its budget resolution for 2005 with no mention of oil and gas revenues from the Arctic Refuge. However, in November 2004, Republicans gained four seats in the Senate, expanding their majority to 55. ANWR drilling advocates predicted that their increased strength in the Senate would help to open the Refuge to oil development. Indeed, their predictions were correct, as in March 2005, the Senate inserted into the budget revenue provision that anticipated oil lease sales in ANWR. A Democrat-led attempt to strip the provision from the budget measure fell short by 49 votes to 51, and therefore this provision became immune to a Democrat filibuster. The budget document became a vehicle for authorising ANWR oil drilling. In lobbying for opening up ANWR for drilling in March 2005, President Bush stressed what he called benefits to opening up drilling in the ANWR, arguing that cracking into the oil field would increase domestic supply while doing negligible damage to the sanctuary. Bush said, “Developing a small section of ANWR would not only create new jobs but would reduce our dependence on foreign oil by up to a million barrels a day.”

However, the Energy Policy Act of 2005, a statute that was passed by Congress on 29 July, and signed into law on 8 August, did not include the provision from the original bill, which called for drilling for oil in the ANWR, and which was approved by Congress on 21 April 2005. This provision was removed by the House-Senate conference committee. Moreover, the ANWR

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781 US Fish and Wildlife Service, *Potential Impacts of Proposed Oil and Gas Development on the Arctic Refuge’s Coastal Plain*.

782 Rutledge, *Addicted to Oil*, p. 73.

783 They include: “Blocking, deflecting or disturbing wildlife; loss of subsistence hunting opportunities; increased predation by arctic fox, gulls and ravens on nesting birds due to introduction of garbage; alteration of natural drainage patterns causing changes in vegetation; deposition of alkaline dust on tundra along roads, altering vegetation over a much larger area than the actual width of road; local pollutant haze and acid rain from nitrogen oxides, methane and particulate emissions; and contamination of soil and water from fuel and oil spills.” US Fish and Wildlife Service, *Potential Impacts of Proposed Oil and Gas Development on the Arctic Refuge’s Coastal Plain*.


785 Filibuster is an informal term for any attempt to block or delay Senate action on a bill or other matter by debating it at length, by offering numerous procedural motions, or by any other delaying or obstructive actions. United States Senate, “Senate Glossary,” [http://www.senate.govpagelayout/reference/b_three_sections_with_teasers/glossary.htm](http://www.senate.govpagelayout/reference/b_three_sections_with_teasers/glossary.htm), [March 20, 2007].


provision was removed from the 2006 budget during the reconciliation process, due to a letter signed by Democrats from the Congress, stating they would oppose any version of the budget that had Arctic Refuge drilling in it.\textsuperscript{789} On 15 December 2005, Senator Ted Stevens (R-Alaska) attached Arctic Refuge drilling language to the annual defence appropriation bill. However, a bipartisan group of Senators led a successful filibustering of the bill on 21 December 2005, and the language was subsequently removed from the bill. In March 2006, the Senate narrowly (by 51 votes to 49) passed a budget amendment in support of opening the ANWR to drilling. A 2007 budget resolution included assumptions of revenue from drilling the Arctic Refuge.\textsuperscript{790} However, as in 2002 and 2003, the budget resolution had fallen a few votes short of the 60 needed to block a Democrat-led filibuster.\textsuperscript{791} Yet a new proposal to open ANWR for drilling was launched by Richard Pombo (R-California), the chairman of the House Resources Committee on 26 May 2006, which followed H.R. 5429 “the American-Made Energy and Good Jobs Act” that was passed by the Congress a day earlier. While these attempts were aimed at opening the ANWR to development, they were later blocked by the Senate.\textsuperscript{792}

Most recently, it became very likely that the Republicans will have to put the ANWR issue on hold for a while, since in November 2006 mid-term elections, both Congress and Senate became controlled by the Democrats, majority of who oppose drilling in Alaska.\textsuperscript{793} However, drilling proponents are certainly not going to give up, which is evident in the fact that President Bush inserted oil drilling on the coastal plain of the Arctic National Wildlife Refuge into the $2.9 trillion budget proposal for fiscal 2008, unveiled on 5 February 2007.\textsuperscript{794} His move will likely amount to little more than wishful thinking, since opening the ANWR for exploration, or passing of any budgets which include ANWR drilling provisions, is now unlikely, especially with the change in power in Congress.\textsuperscript{795}

\textit{Outcome}

Drilling in the ANWR has not yet commenced. Between late 2001 and the November 2006 mid-term elections, the pro-drilling coalition exerted enormous amount of pressure and it appeared that it was just a matter of time before the ANWR would be open for drilling. As in their bargaining against oil companies and their allies over construction of the Alaskan oil pipeline in the early 1970s, the environmentalist-led Alaska Coalition appeared to be on the losing side of the bargain. It seemed probable that they would not be able to compete with big business interests aligned with the Bush administration and the Alaskan government, who attracted a lot


\textsuperscript{790} See Corn, Gelb and Baldwin, “Arctic National Wildlife Refuge (ANWR): Controversies for the 109\textsuperscript{th} Congress.”


\textsuperscript{794} Rose Ragsdale, “Despite Democratic-led Congress, White House Tenders Controversial Petroleum Development Provision in Fiscal 2008 Budget Proposal,” \textit{Petroleum News}, February 11, 2007. Moreover, it has been suggested that for Arctic Power, new leadership in Congress means more work. Longtime pro-ANWR lobbyist Roger Herrera said that “Arctic Power’s been around for the past 13 years, and if you look at the record, you will see that record generally has been quite favorable. They’ve helped to pass ANWR legislation through both chambers of Congress on multiple occasions ... For them to suddenly throw all that away just because of a change of regime in Washington, D.C., and walk away from the issue, doesn’t make much sense to me. I think they will stick around.” Cited in Ragsdale, “Meet Alaska 2007.”

of public support for increasing domestic supplies after 11 September 2001 terrorist attacks and at times of almost record-high oil prices. However, since after the November 2006 mid-term elections Democrats, majority of who oppose ANWR drilling, gained control of both Congress and Senate, drilling in the ANWR is not likely to commence in the next few years, but the ‘game’ is far from over.

**Analyses and Conclusions**

Explicitly citing the need to enhance America’s “energy independence,” a strategic security objective, George W. Bush and Dick Cheney tried in their early days in office to push a bill through Congress that would open a part of the ANWR to oil drilling. In Congress, supporters of the administration’s policies say the country needs ANWR oil to be energy independent and to fight ‘the pinch at the pump’, and drilling advocates claim that ANWR would reduce America’s dependence on foreign producers. In support of Bush and Cheney’s plan, Charli Coon of *The Heritage Foundation* argued, “drilling in the ANWR will not threaten that natural preserve and will increase U.S. energy independence.”

Although the White House may genuinely want more domestic oil production in order to secure oil supplies, administration officials should know well that U.S. energy independence, as least in the short term, is a fantasy. The U.S. oil supply has long lost ground to demand. The United States is a ‘mature’ oil producer: while it consumes 25 percent of the world’s oil, after a century’s heavy production, it now possesses only 2.4 percent of the world’s total oil reserves. Its domestic oil production peaked in 1970, and has been declining steadily ever since. In 2005, it constituted only 60 percent of what it was at its peak, and it covered for only 33 percent of its total oil consumption, allowing the remainder to be covered by increasing imports (see Table 5.1). Many oil industry experts have argued that opening the ANWR for drilling will not solve America’s oil import dependence. For example, Paul Roberts argues, “opening the Arctic to drilling will make little difference.” Kenneth S. Deffeyes claims that even if ANWR is opened for drilling, “U.S. oil production will continue to decline.” Similarly, Roger Blanchard claims that “a decline in U.S. oil production and an increase in imports will occur even if ANWR is opened to oil development” and thus “oil production from ANWR will not solve the problem of high U.S. dependence on oil imports.”

The Bush and Cheney plan outraged the environmentalists because they believed that it would inevitably spoil a pristine wilderness and destroy a habitat for wildlife. Yet the proponents of drilling redoubled their efforts after September 11, arguing that the case for Alaskan oil was only strengthened. The Alaskan proposal has been based on the false premise that America could ever get closer to energy independence. However, not all the oil trapped in Alaska, for that matter, in all protected lands in the country, would provide energy independence, as U.S. oil imports will grow substantially in the future even if the U.S. exploits the last of its untapped regions.

Therefore, the highest influence on the outcome of ANWR bargaining comes from American domestic bargaining theatre, as it is both Congress and Senate approvals which the President needs in order to go ahead with the drilling. Although ANWR has passed the House about 10

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796 For example, see Barnes, “NOCs and U.S. Foreign Policy,” p. 27.
797 Coon, “Tapping Oil Reserves In A Small Part of ANWR.”
801 Deffeyes, *Beyond Oil*, p. 182.
803 Ibid, p. 53.
times, this was to no avail since it did not get the Senate approval, as after Democrat-led filibusters, legislation to open ANWR to drilling required 60 votes. Due to this state of affairs, America’s strategic security concerns, the false perception of ‘energy independence’ if oil from ANWR is brought online in future, plays only a secondary role in determining the potential outcome. Further, high oil prices, albeit not crucial factors influencing the intensity of this particular bargaining case, at their current levels make exploration and production in the ANWR economical. Thus, they increase the interest of the State of Alaska and oil companies, who would profit the most. By drilling in Alaska, IOCs would improve their weak international position (see Chapter 3 and 4) which makes them desperate to get hold of any new reserves.

**Relationship with Hypotheses**

The case study of bargaining for rights to drill in the ANWR has direct relevance to two of the hypotheses set in Chapter 2. The second hypothesis is not supported. Since the interests of American IOCs were not aligned with the entire U.S. Government (the White House, the Congress, and the Senate), thus the support of only a segment of the U.S. Government (the White House and the Senate until November 2006) in bargaining for drilling rights in the ANWR did not result in bargaining success against other actors. Moreover, evidence presented in this case study is supportive of hypothesis four. Although U.S. government’s oil supply security is perceived as threatened when bargaining with other actors, the U.S. government did not emerge victorious from ANWR bargaining due to disunity between the White House and the Senate on one side, and the Congress on the other side. While the Congress supported Chevron in its bargaining with CNOOC in the previous case study, mainly due to the perceived threat to the oil supply security, the same perception was not enough for the Congress to support drilling in the ANWR. For further discussion, refer to Chapter 7.
IRAN

Bargaining in the Iranian oil industry is nested within Iran’s nuclear bargaining. In other words, Iran uses oil, tacitly and explicitly, to gain concessions in nuclear bargaining arena, and to maintain regime stability. Iran’s oil industry is subject to unilateral U.S. sanctions, originally imposed by President Clinton, with a clear political goal in mind, regime change in Tehran, by using economic means – less oil revenue. Iran aims to invalidate the American attempt to isolate it and change the current regime, by protecting regime stability from outside threats (the U.S.) through maintenance of healthy bilateral relations with other key powers, such as China and Russia. This may help Iran in its attempt to acquire nuclear capabilities in the long-run. Iran also aims to protect regime stability from inside threats by ensuring oil revenues remain at high levels, what is essential for safeguarding political stability. Since Iran uses oil as a bargaining tool in order to gain concessions from other countries, this nullifies the U.S. attempt to achieve regime change in Iran by internationally isolating the country.

Introduction to Iran’s Oil Industry

The history of oil industry bargaining in Iran is a story of gradual loss of international control and ownership of the Iranian oil industry. IOCs had the full control over Iranian oil industry in the early stages of the twentieth century. This control gradually obsolesced as the century progressed, resulting in the full national ownership and control. As I brief outline the history of emerging Iranian control over its oil industry, it is evident that in the process, Iranian regimes were very unstable and were overthrown on two different occasions. Thus, given such turbulent political history, regime stability is the main goal of any modern Iranian leader.

While the initial bargain from 1909, heavily favoured the British, the April 1933 concession was signed on terms that were more favourable for the Iranians, but still overall in favouring the


805 Initially, in the early 20th century, the Anglo-Persian Oil Company (later Anglo-Iranian Oil Company, and later BP), in conjunction with the British government, made huge profits compared with what the Iranian government earned in royalties, taxes, and profit sharing. B. Shwadran, Middle East Oil and the Great Powers (New York: Praeger, 1955), pp. 33-37. Also see B. Nirumand, Iran: The New Imperialism in Action (New York: Monthly Review Press, 1969), pp. 26-34; L. P. Elwell-Sutton, Persian Oil: A Study in Power Politics (London: Lawrence & Wishart, 1955). Under the initial concession, the British gained the exclusive rights to explore, produce, and refine oil in all but five
The British succeeded in retaining their monopoly of the Iranian upstream oil industry, and continued the half-century effort of “crudest exploitation.” However, on 1 May 1951, the Iranian Prime Minister, Mohammad Mossadeq declared AIOC nationalised, and set up the National Iranian Oil Company (NIOC) to take over from AIOC. The nationalisation meant Iranian ownership and control of the oil industry. However, Britain rejected the nationalisation as illegal and unacceptable, and was unwilling to give up “the jewel in the crown of BP.” Thus, with American help, Mossadeq was overthrown. Given the widespread anti-British sentiment in Iran, the new Iranian leader, Mohammad Reza Shah Pahlavi (referred to as the Shah) established his regime relying heavily on the Americans, what secured the American, rather than British majority share in the Iranian oil industry. Shah’s regime had traded the control over its oil industry, for what it needed to establish its rule. Only when the Shah abrogated the agreement in 1973, and enforced Iran’s control over its oil industry, from production to pricing, did he finally begin to realise Mossadegh’s nationalisation goal, his own long-term objective, and fulfil Iran’s potential as an oil power.

By the late 1940s and early 1950s a broad cross-section of the Iranian people had not only become conscious of their oil resources and their exploitation by the British against Iranian interests, but were also easily persuaded to rally for a cause that could restore their dignity. See Saikal, The Rise and Fall of the Shah, pp 38-9. For more on Iranian nationalisation and its aftermath, see Mary Ann Heiss, The Rise and Fall of the Shah (Chicago: Chicago University Press, 1971), pp. 18-19; Saikal, The Rise and Fall of the Shah, p. 13.

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Iran implemented the Nationalization Act of 1951 in March 1973 with the “St. Moritz Agreement”. It was to be valid for twenty years, and IOCs were turned into Iran’s long-term and privileged customers.\textsuperscript{812} The realisation of Iran’s oil potential in the interests of the country brought Shah’s regime not only enormous and unprecedented wealth, but also diplomatic strength, with increasing influence in regional and world politics, and in its bargaining with the West, which was increasingly dependent on Iranian oil.\textsuperscript{813} By the late 1970s, the Shah failed to deliver the promises of economic prosperity and political independence. Thus, a wide range of groups within Iranian society questioned his regime.\textsuperscript{814} The 1979 Iranian Revolution, which brought together modern and traditional groups in Iranian society, was caused by modernising impulses and by the disquiet with modernisation among traditional groups. The religious dimension gradually overwhelmed the radical elements, as students and mullahs combined, and in January 1979, the Shah fled.\textsuperscript{815} Ayatollah Khomeini returned triumphant from his period in exile to steer the Iranian Revolution resolutely towards a religious, Islamic Republic.\textsuperscript{816} Soon after, Iranian relations with the United States were seriously damaged due to the hostage taking in the American Embassy in Tehran on 4 November 1979, which lasted for 15 months. While in the immediate aftermath the U.S. President Jimmy Carter responded by placing an embargo on imports of Iranian oil into the United States and by freezing Iranian assets, the Iranians counterattacked by prohibiting export of Iranian oil to any American firm.\textsuperscript{817} Since then, no Iranian oil reached American shores.

Today, Iran’s economy relies heavily on oil export revenues - around 80-90 percent of total export earnings and 40-50 percent of the government budget. Thus, Iran is often viewed as a prototypical ‘rentier’ or petro-state.\textsuperscript{818} High oil prices in the recent years have helped Iran’s economic situation. In 2004, Iran’s GDP increased by 5.8 percent; and in 2005 and 2006, by 5.4 and 4.5 percent, respectively.\textsuperscript{819} The Ministry of Petroleum (MoP) has overall responsibility for

\textsuperscript{810} Saikal, \textit{The Rise and Fall of the Shah}, p. 120. Whose expertise was nevertheless needed for oil operations related to exploration and exploitation.

\textsuperscript{811} However, despite public sympathy with the Palestinian plight during the Yom Kippur War, the Shah continued to maintain an alignment with the U.S. and Israel and in October 1973, Iran defied the Arab oil embargo.

\textsuperscript{812} These included Western-educated professionals, the students from secular universities, the traditional sectors of urban society, the National Front that sought a constitutional monarchy along the lines of the 1906 constitution, and a religious faction led by the Ayatollah Khomeini, demanding the overthrow of the Shah and the creation of an Islamic Republic. Venn, \textit{The Oil Crisis}, p. 23. When in 1978 the Shah tried to repress the religious opposition to his regime, this caused considerable unrest, which was enhanced when, later that year, the Shah’s economic policies, intended to address inflationary pressures, caused recession.

\textsuperscript{813} Ibid, p. 24.

\textsuperscript{814} Inevitably, the strikes in the oil industry, which were commonplace before and during the Revolution, rapidly had an impact upon Iranian production, which dropped from 6 million bpd in September 1978, to 500,000 bpd in January 1979. Since Iran was the second largest oil exporter in the world, the impact of strikes was immediately felt on the oil markets, carrying prices from 13 to 34 dollars a barrel, and causing the second oil shock, and resulting in many oil companies being hard hit by the lack of supplies from Iran. This was particularly so for the BP, whose 40 percent of supplies came from Iran. Yergin, \textit{The Prize}, p. 685.

\textsuperscript{815} As a result, little or no Iranian crude entered the United States ever since 1979. It is important to note that in 1978, a quarter of U.S. oil imports from the Middle East came from Iran. Energy Information Administration, “Monthly Energy Review,” July 2004, \url{www.eia.doe.gov/emeu/mer/petro.html} [July 1, 2004]. This just caused more havoc on the oil markets, causing the price to rise to over $45 a barrel. Yergin, \textit{The Prize}, p. 702.


\textsuperscript{817} “Iran Country Analysis Brief,” Energy Information Administration, \url{www.eia.doe.gov}, March 2005 [November 2, 2005].
the country’s energy sector. NIOC is a subsidiary, which is responsible for oil and gas exploration and production, refining and oil transportation. NIOC is an agent of the state and the source of income for the entire structure of the Iranian welfare state. NIOC must follow government directives on what projects to pursue, and as the government is responsible for NIOC’s budget, there is no room for company autonomy on deciding spending plans. Moreover, NIOC has little leeway in the wider course of Iran’s foreign relations, and in particular, when it comes to the crucial question of oil sales, which are crucial to Iran’s national security. In a sense, since MoP practices high level of control over NIOC, there is a blurring of boundaries between Ministry and NIOC.

In 2005, Iran held 137.5 billion barrels of proven oil reserves, second largest in the world, and 11.5 percent of world total, following discoveries in the Kushk and Hosseineh fields in 2004. The vast majority of Iran’s crude oil reserves are located in giant onshore fields in the southwestern Khuzestan region near the Iraqi border and offshore in the Persian Gulf, and in total, Iran has 33 onshore and 13 offshore oil fields. In recent years, some analysts believed that Iran’s capacity would drop until new oilfield developments (Azadegan, Bangestan) come online, since Iran’s existing oilfields have a natural decline rate estimated at 8-13 percent per year (300,000-500,000 bpd) and are in need of upgrading, modernisation, and enhanced oil recovery efforts (i.e., gas reinjection). For example, the EIA considered Iran’s oil sector as “old and inefficient, needing thorough revamping, advanced technology, and foreign investment.”

However, data from 2001-2005 proved these analysts wrong (see Table 6.1). During 2004 and 2005, Iran produced 4 to 4.1 million bpd of oil, and was the fourth largest producer in the world, considerably higher than 3.4 million bpd produced during 2002 (see Table 6.1). This is primarily so since the NIOC employs a large number of experienced and skilled workers, with many competent individuals, especially on the technical side. Throughout the slow-down in decision-making that followed the 2005 presidential election, NIOC maintained its operations and even had some success in stemming the decline in oil production. Between the 1979 Iranian Revolution, before which Iranian oil production peaked at 6 million bpd, and 2004, Iranian oil production did not surpass 4 million bpd on annual basis (see Table 6.1 and Figure 6.1). Moreover, it reached a low of 1.3 million bpd in 1981 after the start of Iran-Iraq War, and during the 1980s, Iran maintained production levels at some older fields only by using methods that have permanently damaged the fields. However, despite these problems and against pessimistic Western predictions, in recent years Iran managed to increase its production to the highest level since 1979. In addition, a series of changes stand to benefit NIOC in future. Under the previous Oil Minister, Bijan Namdar Zanganeh, the managing director of NIOC, Mehdi Mirmoezzi, was regarded as a figurehead. However, the recently appointed head of NIOC, and the new deputy

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820 Nearly all government spending, from the military to education to food subsidies, is ultimately derived from money NIOC remits to the national treasury. Daniel Brumberg and Ariel I. Ahram, “The National Iranian Oil Company in Iranian Politics,” paper prepared in conjunction with an energy study sponsored by Japan Petroleum Energy Center and the James A. Baker III Institute for Public Policy, Rice University, March 2007, p. 24.
821 The more crucial the project is to Iran’s larger foreign policy objectives, the less discretion NIOC maintains. Brumberg and Ahram, “The National Iranian Oil Company in Iranian Politics,” pp. 31–2.
822 For more on MoP’s control of NIOC, see Marcel, Oil Titans, pp. 85, 102 and 136-8. For more on NIOC, see http://www.nioc.com, and Brumberg and Ahram, “The National Iranian Oil Company in Iranian Politics.”
824 Brumberg and Ahram, “The National Iranian Oil Company in Iranian Politics,” p. 3.
825 Iran Country Analysis Brief.”
826 Ibid.
828 Iran Country Analysis Brief.”

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Oil Minister (since January 2006), Gholamhossein Nozari, has sound knowledge of the industry, as he was previously in charge of the oilfields in central Iran.\textsuperscript{829}

Table 6.1: Iran's Crude Oil Production and Consumption (Selected Years and 1994-2005)

<table>
<thead>
<tr>
<th>Year</th>
<th>Production (mbpd)</th>
<th>Consumption (mbpd)</th>
<th>Balance (mbpd)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1974</td>
<td>6.060</td>
<td>0.503</td>
<td>5.557</td>
</tr>
<tr>
<td>1981</td>
<td>1.321</td>
<td>0.570</td>
<td>0.751</td>
</tr>
<tr>
<td>1994</td>
<td>3.730</td>
<td>1.099</td>
<td>2.631</td>
</tr>
<tr>
<td>1995</td>
<td>3.744</td>
<td>1.227</td>
<td>2.517</td>
</tr>
<tr>
<td>1996</td>
<td>3.759</td>
<td>1.292</td>
<td>2.467</td>
</tr>
<tr>
<td>1997</td>
<td>3.776</td>
<td>1.269</td>
<td>2.507</td>
</tr>
<tr>
<td>1998</td>
<td>3.855</td>
<td>1.221</td>
<td>2.634</td>
</tr>
<tr>
<td>1999</td>
<td>3.603</td>
<td>1.243</td>
<td>2.360</td>
</tr>
<tr>
<td>2000</td>
<td>3.818</td>
<td>1.319</td>
<td>2.499</td>
</tr>
<tr>
<td>2001</td>
<td>3.730</td>
<td>1.331</td>
<td>2.399</td>
</tr>
<tr>
<td>2002</td>
<td>3.414</td>
<td>1.429</td>
<td>1.985</td>
</tr>
<tr>
<td>2003</td>
<td>3.999</td>
<td>1.513</td>
<td>2.486</td>
</tr>
<tr>
<td>2004</td>
<td>4.081</td>
<td>1.575</td>
<td>2.506</td>
</tr>
<tr>
<td>2005</td>
<td>4.049</td>
<td>1.659</td>
<td>2.390</td>
</tr>
</tbody>
</table>

Source: \textit{BP Statistical Review of World Energy 2006}

Figure 6.1: Iran's Crude Oil Production and Consumption (1966 - 2005)

Source: \textit{BP Statistical Review of World Energy 2006}

In 2005 Iran exported around 2.4 million bpd of oil (Table 6.1), with major customers including Japan, China, South Korea, India, Taiwan, and Europe, thus making it the fifth largest crude oil exporter in the world (see Table 1.1). Of total oil exports, 56 percent went to Asia and 29 percent to Europe. Iran's domestic oil consumption, 1.6 million bpd in 2005, is increasing rapidly as the economy and population grow (see Table 6.1). This is exacerbated by the fact that Iran heavily subsidises the price of oil products, resulting in a large amount of waste and inefficiency in oil consumption.

\textsuperscript{829} Ibid.
With sufficient investment, Iran could increase its crude oil production capacity significantly, but it is uncertain if it can produce over its previous peak of 6 million bpd. The government has ambitious plans to increase oil production to over 5 million bpd by 2009, and 7 million bpd by 2024,430 and it is counting on billions of dollars in foreign and local investment to increase oil production. While some have suggested this is unlikely to be achieved without a significant change in policy to attract such investment,431 this may not be the case as many companies, both oil-importing countries’ NOCs and IOCs are more than willing to enter Iran even under unfavourable terms. Attracting investment may not have to include a change in relations with the West, as new investment is likely to come from Chinese, Russian, Brazilian, Malaysian, and Indian, mainly state-owned oil companies. This is more than obvious in Venezuela (see Chapter 4), a country that is very efficient in attracting non-Western investment. Moreover, although not sufficient per se to achieve a significant increase in production, local investors can compete with foreign companies.

The Iranian constitution prohibits the granting of petroleum rights on a concessionary basis or direct equity stake. Iran is reluctant to allow more favourable terms for IOC investment, since due to the hard-fought process of nationalisation and strong negative feelings towards the British and the Americans, “Iranians display a feeling of pride in their industry and some resistance to foreign intrusions in it.”432 However, the 1987 Petroleum Law permitted the establishment of contracts between the MoP, state companies and “local and foreign national persons and legal entities.” Buyback contracts, originally designed in 1995, are arrangements in which the contractor funds all investments, receives remuneration from NIOC in the form of an allocated production share, usually between 15 and 17 percent, and then transfers operation of the field to NIOC after the contract is completed.433 It is important to note that Iranian MPs were as of mid-2006 studying a new bill that would give the Majlis (Iranian parliament) more supervisory powers over buybacks. Although terms of buyback contracts have been slightly modified in January 2004, the importance of these reforms, according to Roger Howard, “should not be exaggerated” as they still carry numerous disadvantages for foreign investors.434 Meanwhile, they benefit Iran in two major ways: firstly, they require that a contracted oil company transfers technology to the NIOC; and secondly, they necessitate maximum use of domestic engineering, technical, and executive capabilities in order to promote the quality of domestic sources, and thus reinforce the first requirement.

In general, some argue that buyback agreements have not attracted the flood of foreign energy investment Iran both needs and wants,435 and that Iran’s restrictive petroleum law remains a hindrance to foreign investment.436 However, the ambitious agreement between Iran and China (through Sinopec) under which China may buy between $70 billion and $100 billion of Iranian oil and natural gas over the next 30 years, points to the contrary. This deal refutes complaints by European IOCs present in Iran, such as Total and Royal Dutch/Shell, who often complain

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430 Ibid.
431 Ibid.
432 Marcel, Oil Titans, pp. 39 and 42-3.
433 For more on buyback contracts in Iran see “Iran Country Analysis Brief,” Roger Howard, Iran Oil: The New Middle East Challenge to America (London: I.B. Tauris, 2007), pp. 33-6; Mike Buntler, “The Iranian Buy Back Agreement,” Oil, Gas & Energy Law Intelligence, vol. 1, no. 2, March 2003; and Bindemann, Production-Sharing Agreements, pp. 75-81. For comparison between “buyback” agreements and PSAs, see Marcel, Oil Titans, p. 43.
434 For more detail, see Howard, Iran Oil, pp. 34-5.
435 “Iran Country Analysis Brief.”
about terms of buyback contracts, and attempt to tacitly bargain for their improvement. As of 2006, foreign companies involved in ‘buyback’ oil operations in Iran came from the E.U. countries (U.K., France, Italy, Austria, Spain), Norway, Japan, Malaysia, India, China, Brazil, Canada and Russia.

Although in 1994, 23 percent of Iranian oil exports were moved by American IOCs, in 1995, Iran became closed to the American oil companies, due to the official U.S. policy of isolating the Iranian economy. In 1995, President Clinton signed an executive order that bars American companies from conducting business with Iran. Clinton’s decree took effect on 6 March 1995, stopping American companies from purchasing Iranian crude oil, $4 billion worth of which had been bought in the previous financial year. After issuing the decree, Clinton stated, “there are times when important economic interests must give way to even more important security interests, and this is one of those times.” This decree was extended after 6 May 1995, when the President formally declared a national state of emergency between Iran and the United States, claiming “an extraordinary threat to the national security, foreign policy and economy of the U.S. constituted by the actions and policies of the government of Iran.” The subsequent Executive Order was later consolidated and clarified by the administration on 19 August 1997 before being continued by President Bush on 14 March 2003. In March 2004, President Bush extended the decree, citing the “unusual and extraordinary threat” to U.S. national security posed by Iran. He once again extended the decree on 15 March 2006, citing exactly the same reason. Moreover, in 1996, the U.S. Congress adopted the Iran and Libya Sanctions Act (ILSA), imposing severe penalties on non-U.S. firms that invest more than $20 million in Iran’s oil industry. This Act has been extended for five years in August 2001, and tightened, codified, and renamed to Iran Freedom and Support bill by the Congress in April 2006, but has not been invoked as of early 2007.

Unsurprisingly, the above measures have deterred U.S. firms from making investments in Iran’s oil industry and buying Iranian crude, and against its will, Conoco had to give up a lucrative $1.6 billion contract to develop two Iranian offshore oil fields. However, ILSA has not been effective in stopping non-U.S. firms from investing in Iran, especially considering the number of foreign oil companies active in that country. The European Union opposes the enforcement of

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838 Howard, Iran Oil, p. 11.
839 Cited in ibid, p. 12.
841 “Iran Country Analysis Brief.”
842 Howard, Iran Oil, p. 13.
843 See “Iran and Libya Sanctions Act of 1996,” Public Law 104-172, August 5, 1996. There are six sanctions, to two of which a company could potentially fall foul under the act. These include a ban on its imports of goods or services into the USA; a federal government ban on the purchase of its goods and services; the imposition of a loan ceiling of $10 million by all U.S. financial institutions; prohibiting the sanctioned entity from acting as a primary dealer of U.S. treasury bonds; a ban on U.S. export-import assistance; and a denial of licences that approve the export of controlled technology to the company. Howard, Iran in Crisis p. 160. For more on U.S. sanctions on Iran, see Patrick Clawson, “Iran,” in Richard N. Haass (ed.), Economic Sanctions and American Diplomacy (New York: Council on Foreign Relations, 1998); Howard, Iran Oil, pp. 12-6; Jahangir Amuzegar, “Adjusting to Sanctions,” Foreign Affairs, vol. 76, no. 3, May/June 1997, pp. 31-41; and Jahangir Amuzegar, “Iran’s Economy and the US Sanctions,” Middle East Journal, vol. 51, no. 2, Spring 1997, pp. 185-99. In April 2004, the ILSA had been terminated with respect to Libya.
844 For more, see Howard, Iran Oil, pp. 18-9.
846 Howard, Iran Oil, p. 12.
ILSA sanctions on its members, and on 22 November 1996 passed Resolution 2271 directing EU members not to comply with ILSA. American IOCs have argued that U.S. unilateral sanctions give their European rivals an unfair advantage, and when considering the above, Iran is one case where interests of the U.S. government and those of its IOCs diverge. It is clearly against companies’ interests not to be involved in Iran, the country with the world’s second largest oil reserves. Joint Economic Committee of the U.S. Congress issued a research report on Iran’s oil and gas wealth in March 2006, arguing, “ILSA is believed to have limited Iran’s oil production capabilities.” However, empirical evidence points to the contrary as Iran’s oil production between 1996, the year ILSA was adopted, and 2005, grew by 7.7 percent, or 290,000 bpd (see Table 6.1).

In 2006, the U.S. Government has been applying a lot of pressure against European governments to pressure the E.U.-based oil companies to pull out of Iran. Thus, in case stricter economic sanctions against Iran were implemented in future, both Total and Royal Dutch/Shell would abandon their activities in Iran. In addition, Royal Dutch/Shell and ENI of Italy have already decided not to bid for rights to develop Azadegan, a large Iranian oilfield mainly due to political reasons.

At times when oil prices are high and cash is not scarce, Iranian oil companies are able to invest in local oil projects. For example, MoP signed a deal with NIOC’s subsidiary PetroIran to develop technologically challenging Bangestan field. On 18 March 2005, a much-sought-after contract to develop this giant field was awarded to PetroIran, after having been delayed several times since 2001. Bangestan contains an estimated 6 billion barrels of oil reserves and produces about 250,000 bpd, but the field is one of the oldest in the country, requiring investment and complex technological applications. In April 2003, Shell stated that it was frustrated with the slow pace of negotiations on Bangestan, including numerous changes to terms of the project. Total and BP then unsuccessfully bid on the project, which was awarded to PetroIran. Development of Bangestan could cost $3 billion over 10 years, and aims to raise output to 600,000 bpd. Similarly, in bidding for the tender for Phase 1 buyback agreement for South Pars oil and gas field, PetroPars, a local company, undercut the next best bidder, Total, by over 50 percent, thus making Total’s bids on subsequent phases much more competitive. These examples of domestic firms competing against IOCs in bidding for contracts show that at times when oil prices are high, Iran possesses both money and expertise to develop technologically complex and expensive oilfields, without relying heavily on foreign investors.

852 “Iran Country Analysis Brief.”
CASE STUDY 6: Oil Industry and Nuclear Bargaining in Iran – ‘Using Oil as a Shield’

Oil industry bargaining in Iran is highly influenced by issue linkage. Iran uses oil as a bargaining chip in its nuclear bargaining with the international stakeholders. Oil has played a big part in Iran’s newly found nuclear defiance. Tehran uses oil to threaten retaliation against its enemies and critics, while it rewards those countries that take its side, notably China. In order to understand the importance of Iranian oil, and how it is used as a bargaining chip, I firstly examine Iran’s internal political structure in order to find the drivers behind Iran’s nuclear pursuit, and here I argue that regime stability is the primary goal of its current rulers. Secondly, I analyse the Iranian nuclear programme, and the U.S. response to it, which centres on the attempt to replace the current regime. Thirdly, I discuss the ineffectiveness of American efforts at regime change in Tehran, and argue that Iran’s oil has been the main culprit.

In the 1990s and in the current decade, the political stability in Iran has been affected by internal and external developments. Domestically, in the 1990s the ayatollahs were seen to be losing power, the political scene was increasingly fragmented and despite predictable American hostility, there were signs of liberal reform. However, the political powers of the conservative Supreme Leader Ayatollah Ali Khamenei, successor of the revolutionary Khomeini, dwarfed those of the elected reformist President Mohammad Khatami, evident in the power of Iran’s Guardian Council. Moreover, with hardliners regaining control of the parliament in 2004, and when Mahmoud Ahmadinejad, a hardliner, replaced Khatami as Iranian President following the June 2005 presidential election, any hope of liberal reform diminished since conservatives now dominate all the organs of government. Externally, according to Iranian hardliners, the U.S.-led wars in Afghanistan and Iraq were completing the final stage in the U.S. military encirclement of their country, which was denounced as an “axis of evil” member by U.S. President George W. Bush. Accordingly, there were suggestions that Iran would become a U.S. target after Iraq – a course of action favoured by Israel, and that regime change was on the American agenda.

Stalwarts of the Islamic Revolution launched by Ayatollah Khomeini in 1979 control Iran’s judiciary, the Council of Guardians (the constitution’s regulator), and other powerful institutions, as well as key coercive groups such as the Revolutionary Guards and the Islamic vigilantes of the Ansar-e-Hezbollah. The hardliners consider themselves the most ardent Khomeini disciples and think of the revolution less as an antimonarchical rebellion than as a continued uprising against the forces that once sustained the U.S. presence in Iran: Western imperialism, Zionism, and Arab despotism. In reaction to the U.S.-led overthrow of two regimes on Iran’s periphery, Afghanistan and Iraq, they have adopted a wary stance, and even the influential moderate conservative former president Hashemi Rafsanjani warned, “We are facing a cruel and powerful U.S. government, and we have to be cautious and awake.” Iran’s supreme religious leader, Ayatollah Khamenei, one of the country’s most hawkish thinkers, shares the hardliners’ revolutionary convictions and their confrontational impulses, and lately, the Middle East’s changing political topography has forced his hand somewhat. With the American imperium encroaching menacingly on Iran’s frontiers, Khamenei, who exclusively controls foreign relations

854 Howard, *Iran Oil*, p. xii.
as according to the Iranian Constitution, has been pragmatic on many issues. Khamenei and other conservatives have tried to develop economic and security arrangements with foreign powers such as China, the European Union, Japan, India and Russia, in order to preserve the regime stability and counter the American and Israeli threat.

Conservatives, who view a conflict with the United States as inevitable, believe that the only way to ensure the survival of the Islamic Republic is to equip it with an independent nuclear capability, and they press for a nuclear breakout in defiance of international opinion. Moreover, “the nuclear temptation is widely shared across the Iranian political spectrum,” and “many Iranians profess to support the government’s pursuit of nuclear technology.” Ali Akbar Nateq-Nuri, a conservative presidential candidate in 1997 and now an influential adviser to Khamenei, dismissed Tehran’s 2005 negotiations with the Europeans, noting, “Fortunately, the opinion polls show that 75 to 80 percent of Iranians want to resist and [to] continue our program and reject humiliation.” Once in power, Ahmadinejad, a populist, a staunch supporter of Iran’s nuclear program, and a mirror image of George W. Bush due to his open disdain for the opinions of others about his policies, made a defiant speech at the UN on the nuclear issue, and refused to back down on Tehran’s discussion to resume uranium conversion. In the cosmology of such hardliners, nuclear arms have not only strategic value, but also currency in domestic politics. Iranian conservatives see their defiance of the ‘Great Satan’ as a means of mobilising nationalistic opinion behind a revolution.

If Iran acquires nuclear weapons capability, it would never use it. In other words, it would use its nuclear capability as a deterrent, and therefore in strictly defensive purposes, in order to maintain regime stability from outside threats. In general, according to Charles Glaser and Steve Fetter, “the key reason for a state to acquire nuclear weapons is deterrence.” Shahram Chubin and Robert Litwak argue that by developing nuclear weapons, Iranians “do not seek to threaten their neighbours.” Ray Takeyh confirms this view, and argues that Iran’s quest for nuclear weapons stems “from a judicious attempt to craft a viable deterrent posture against a range of threats.” In relation, Pollack and Takeyh argue that the demonstration of the deterrent value of nuclear weapons by North Korea may have increased Iran’s determination to acquire them. Against the background of war in Afghanistan and U.S. and Israeli rhetoric about eradicating terrorists and the states that sponsor them, former Iranian President Rafsanjani invoked a hypothetical Muslim nuclear capability “as a second-strike deterrent against pre-emptive attacks by Israel or

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859 Ibid.


864 Iran almost certainly does not intend to show off a nuclear bomb in an attempt to intimidate its regional enemy, Israel, or its global nemesis, the United States, as such hostility could be catastrophic for the Islamic Republic. De Bellaigue, “Iran,” p. 20.


866 Chubin and Litwak, “Debating Iran’s Nuclear Aspirations,” p. 111. Moreover, they argue that “The only conceivable justification for Iran’s acquisition of nuclear weapons might be that they are needed as a deterrent against the U.S.” (p. 113).


the U.S. against Iran.” Iranians argue that they need nuclear weapons to “equalise” and deter the U.S. acting alone or in concert with Israel. For many in Tehran, “maintaining some sort of nuclear program offers the single most valuable enhancement of the country’s bargaining position with Washington.” In this context, all the threatening references against Israel made by Ahmadinejad are not propounded as meaningful statements of policy but deployed as rhetorical devices designed to please mass audiences.

In summary, in the domestic arena, Iranian conservatives, who now fully control Iranian politics, seek regime stability. This, domestic goal, is overarching and influences Iran's foreign affairs. Therefore, any foreign policy goals are subjected to and influenced by the main goal – regime stability from domestic and foreign threats (the U.S. and Israel). Development of nuclear weapons, maintaining high revenues from oil exports, close relations and support from China, Russia, India, Japan and the E.U. are all pragmatic means to this end. Therefore, the ability of Iran's pragmatic conservative leadership to deliver material benefits from oil and gas exports is used to ensure regime legitimacy and survival. It is easy to understand why regime stability is the most important objective given Iran's turbulent political history.

Table 6.2: Goals of Main Actors in Oil Industry and Nuclear Bargaining in Iran

<table>
<thead>
<tr>
<th>Actor</th>
<th>Bargaining Goals</th>
</tr>
</thead>
<tbody>
<tr>
<td>Iranian leaders</td>
<td>Primary goal of regime stability; hence increasing or maintaining the current levels of oil export revenues needed to maintain economic growth and domestic order; oil used as a bargaining token in nuclear weapons development, and nuclear weapons would serve as a deterrent against any outside threats</td>
</tr>
<tr>
<td>The U.S. government</td>
<td>Regime change in Iran; no nuclear weapons development by the regime; moreover, since there is a need for additional sources of oil in line with its diversification policy, replacing the current regime in Tehran with a friendly one would resume Iranian oil exports to the U.S.</td>
</tr>
<tr>
<td>American IOCs</td>
<td>Entry into Iran regardless of which regime is in power</td>
</tr>
<tr>
<td>E.U. governments</td>
<td>Status quo preferred as long as Iran cooperates regarding its nuclear program; a lot of European oil companies active in Iran and much of Iranian oil heads to Europe</td>
</tr>
<tr>
<td>The government of the PRC</td>
<td>Status quo oriented; nuclear Iran tolerable; high importance given to increasing Iranian oil exports to China</td>
</tr>
<tr>
<td>The Japanese government</td>
<td>Although it would want to develop lucrative Iranian oil fields, it might have to succumb to the U.S. pressure against it</td>
</tr>
<tr>
<td>Vladimir Putin and the Russian government</td>
<td>Positive relations with the Iranian regime; aiming at increased oil and gas cooperation and investment opportunities, as well as nuclear research help, and conventional weapons sales</td>
</tr>
<tr>
<td>The Israeli government</td>
<td>Regime change in Iran; preserving nuclear hegemony in the region, and thus strictly against nuclear weapons development; not interested in Iranian oil</td>
</tr>
<tr>
<td>IAEA</td>
<td>Pushing Iran to allow more inspections into its nuclear</td>
</tr>
</tbody>
</table>

870 Ibid.
<table>
<thead>
<tr>
<th>European oil companies</th>
<th>Status quo preferred, as American companies are not involved in Iran due to American sanctions, and thus they have less competition; hoping the U.S. will not punish them for violating the U.S.-imposed sanctions against investment in the Iranian oil industry</th>
</tr>
</thead>
<tbody>
<tr>
<td>The Indian government</td>
<td>Increased energy cooperation with Iran</td>
</tr>
</tbody>
</table>

**The Nuclear Issue**

In the late 1980s, after the Iran-Iraq War, the need for electricity generation for reconstruction of the war-damaged economy was evident and as the maximum export of hydrocarbon resources was to be achieved for foreign exchange requirements, the focus was on rebuilding the Bushehr nuclear power plant, destroyed during the war.\(^\text{873}\) Today, Iran has a civilian nuclear-power reactor under construction, as the Russians are building the 1,000 megawatt-electrical light-water reactor, of the Russian VVER type, at Bushehr.\(^\text{874}\) This power reactor is the first in a series of power reactors planned to generate 6,000 megawatts of electricity. It is reported that Iran intends to build a second power reactor at the Bushehr site of a similar type as the first and with Russian assistance.\(^\text{875}\) In addition, Iran operates four small research reactors, three supplied by China in 1992 and 1994, located at the Eshafan Nuclear Technology Centre, and one supplied by the U.S. in 1967, at the Nuclear Research Centre in Tehran.\(^\text{876}\)

In 2006, the IAEA concluded that Iran was in pursuit of nuclear weapons and the issue was referred to the U.N. Security Council on 4 February 2006.\(^\text{877}\) In late March 2006, Iran was given a 30-day ultimatum to return to the negotiating table or face isolation.\(^\text{878}\) Much of the argument over the intentions of Iran’s nuclear program revolves around a single proposition: given that Iran has enormous oil and gas reserves, it has no need for nuclear power for domestic energy needs and thus its nuclear program will be used for nuclear weapons. Like much of conventional wisdom, is this a highly misleading and debatable cliché? Certainly, both sides of the debate have some strong evidence to support their argument.

On one side, there are those who believe Iran is developing a civilian nuclear program, as nuclear power is necessary for rising domestic energy consumption, while oil and gas are needed to generate foreign currency,\(^\text{879}\) since earnings from oil make up 40 to 50 percent of total

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\(^{873}\) Isenberg, “The Fuel Behind Iran’s Nuclear Drive.”

\(^{874}\) It will use low enriched uranium as fuel. Under the contract, Iran has with Russia, the latter will provide the fuel for the lifetime of the reactor and will take back to Russia the spent fuel for storage and possibly reprocessing.


\(^{876}\) Ibid.


\(^{879}\) In showing that Iran possibly has genuine need for nuclear energy, some British officials argue that were it not for worries over potential military applications, Iran’s attempt to meet burgeoning demand through nuclear power would make economic sense. The Foreign Affairs Select Committee of the British Parliament said in March 2004 that based on a study it commissioned, “it is clear … that the arguments as to whether Iran has a genuine requirement for domestically produced nuclear electricity are not all, or even predominantly, on one side.” Some U.S. arguments against Iran “were not supported by an analysis of the facts,” the committee added, noting that
government revenues. Given that lower export-revenues directly reflect on the economic situation in the country, if Iran manages to secure an indigenous supply of nuclear fuel then more crude oil can be exported, and this would in turn bring in more revenues. Thus, since Iran’s population and oil and gas consumption increased considerably, and oil production decreased, they argue that Iran’s energy situation today is quite different from the late 1970s,880 when the Shah’s regime also pursued nuclear technology.881 This pursuit was not alarming to the West at the time, since the U.S. President Gerald Ford signed a directive in 1976 offering Tehran the chance to buy and operate a U.S.-built reprocessing facility for extracting plutonium from nuclear reactor fuel.882 Moreover, proponents of the argument that Iran’s nuclear program will be used for civilian purposes argue that as a sovereign nation Iran is entitled to make its own sovereign decisions as to how to provide for its own energy needs.883 Arguably, since Iran is a resource-rich country, among these resources, there are several uranium mines whose energy contents cannot be overlooked. Thus, expecting Iran to disregard this valuable resource is irrational.884 Finally, proponents of the argument that Iran’s nuclear program will be used for civilian purposes claim that Iran derives strategic significance from its status as an oil exporter.

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880 Iran, in years prior to the 1979 Revolution, had population of approximately 35 million, and was producing between 5.5 and 6 million bpd of crude oil, and its domestic consumption was between 10 and 11 percent of that output. Its annual natural gas production was roughly about 17 to 20 billion m³ of which some 7 to 8 billion m³ was exported to the Soviet Union and the remaining 10 to 12 billion m³ was consumed domestically (BP Statistical Review of World Energy 2006). In 2005, Iran had a population of more than 69 million, most of which are choking from air pollution. Iran’s population is projected to rise to 81 million by 2015, 91 million by 2025 and 121 million by 2050 (John W. Wright (ed.), The New York Times 2005 Almanac (London: Penguin Books, 2004), p. 469). Meanwhile, in 2005, the country produced some 4 million bpd of crude oil, of which over 1.6 million bpd or over 40 percent were consumed domestically, and 87 billion m³ of natural gas, which was not enough to satisfy domestic demand of 88.5 billion m³, so Iran had to import natural gas (BP Statistical Review of World Energy 2006). Driven by a young population and high oil revenues, Iran’s power consumption is growing by around 7 percent annually, and its capacity must nearly triple over the next 15 years to meet projected demand. For more, see Christopher de Bellaigue, “Iran,” Foreign Policy, no. 148, May-June 2005, p. 19.

881 The Shah argued that hydrocarbon resources would be too valuable to burn by the beginning of 21st century and most of Iran’s electricity generation must be supplied from nuclear power plants by then (Saikal, The Rise and Fall of the Shah, pp. 127. and 160). Iran had signed a number of nuclear power construction contracts with France and West Germany and was negotiating with others for additional ones. The stated objectives of these undertakings were to generate electricity and desalinate water, and there was no overt opposition to the Shah’s nuclear ambitions because of friendly relations between Iran and the U.S. (Isenberg, “The Fuel Behind Iran’s Nuclear Drive”).

882 The deal was for a complete “nuclear fuel cycle” reactors powered by and regenerating fissile materials on a self-sustaining basis. Thus, the U.S. actually encouraged the Shah to develop a nuclear energy program, reasoning that substituting nuclear energy for domestic consumption would make available more Iranian petroleum for export. Muhammed Sahimi, “Iran’s Nuclear Energy Program,” Harvard International Review, vol. 26, no. 5, 2005. David Kay, speaking in November 2004 at a forum sponsored by the Center for Strategic and International Studies (CSIS) said “The first thing – of what we do know, and it’s amazing how many Americans seem to skate over this – the first nuclear reactor given to Iran was given by the United States in 1967 – a five-megawatt trigger reactor, research reactor, under the Eisenhower Atoms for Peace Program. … The other thing that Americans forget is that in 1974, the Shah announced a policy of 23,000 megawatts of nuclear energy in Iran. The U.S. reaction? [Former U.S. National Security Adviser and Secretary of State] Henry Kissinger beat down the door to be sure that the two U.S. constructors, General Electric and Westinghouse, had a preferred position in selling those reactors. We did not say, “It’s a stupid idea, why would you want to do that when you are flaring gas and you have immense oil reserves?” We said, “That is very interesting; it’s an example of how the Iranian economy is moving and becoming modern.” Imagine in Iranian ears how it sounds now when we denigrate that capacity. They remember. We were sellers of nuclear reactors and wanted to be sellers of nuclear reactors to the Shah.” Cited in ibid.

883 Under Article IV of the Nuclear Non-Proliferation Treaty (NPT), member states are assured access to the benefits of civilian nuclear energy (UN Department for Disarmament Affairs, “The Treaty on the Non-Proliferation of Nuclear Weapons (NPT),” 2002, disarmament2.un.org/wmd/npt/npttext.html [November 12, 2005]).

884 Isenberg, “The Fuel Behind Iran’s Nuclear Drive.”
Iran wants to maintain this status, and any initiative that would maximise Iran’s hydrocarbon export potential has strategic value.\textsuperscript{885}

On the other side, investigators from the IAEA have discovered that Iran is trying to acquire the capability to enrich uranium and separate plutonium, activities that would allow it to make fissile material for nuclear weapons. The Iranian government has admitted to these activities only after the National Council of Resistance, an Iranian opposition group, announced that they were underway at sites in Natanz and Arak. Both the uranium enrichment and the heavy water production plants raise concerns.\textsuperscript{886} Iran violated its Safeguards Agreement with the IAEA, required by the NPT, by failing to report many of its nuclear-related activities to the Agency. It has failed to ratify the Additional Protocol to its Safeguards Agreement with the IAEA.\textsuperscript{887} Although there is no firm evidence that Iran intends to fabricate nuclear weapons, revelations of Iran’s allegedly massive secret program have convinced even doubtful European governments that Tehran’s ultimate aim is to acquire the weapons or, at least, the ability to produce them whenever necessary.\textsuperscript{888}

When taking all these factors into consideration, Iran’s nuclear program appears aimed at dual, both military and civilian, purposes. If Iran wanted nuclear technology for peaceful uses, it is fair to ask, why did it hide and deny efforts to get that technology?\textsuperscript{889} The Iranians argue that alerting the world to its nuclear acquisitions would have allowed the United States to block its supply lines. That may be true, but there is another possible explanation: Iran hid its interest in nuclear technology because that interest was primarily military in nature. IAEA’s failure to find hard evidence that Iran is trying to weaponise its nuclear technology does not mean that there is no such effort. There is plausible circumstantial evidence, most of it collected by the IAEA, to suggest that Iran’s nuclear program is not purely civilian. For more than 10 years, Iran concealed important changes to its nuclear inventory and maintained a clandestine procurement effort.\textsuperscript{890} Some of Iran’s actions violated the explicit terms of the NPT; others flouted its spirit.\textsuperscript{891}

\textit{The U.S. Reaction}

\textsuperscript{885} Ibid.

\textsuperscript{886} A heavy-water reactor is a particularly efficient way of producing plutonium for use in nuclear weapons. A uranium enrichment plant can produce the highly enriched uranium needed for nuclear weapons. Apart from these, there are other Iranian nuclear activities that raise suspicions. These include: the development of uranium mines; the construction of a uranium conversion facility at the Esfahan Nuclear Technology Centre (ENTC) to convert uranium ore (yellow cake) into uranium hexafluoride gas, suitable for use in gas centrifuges for the enrichment of uranium; and the operation of a pilot laser enrichment facility at Lashkar Ab’ad, now shut down Barnaby, “Iran’s Nuclear Activities,” p. 1. For a detailed account of Iranian nuclear activities see Christoph Wirz, “Is Iran on the Way to Acquiring an Atomic Bomb?” Spiez, Switzerland: Spiez Laboratory, January 2004.

\textsuperscript{887} Barnaby, “Iran’s Nuclear Activities,” p. 2. This protocol would permit the IAEA improved access to Iran’s nuclear facilities, including the collection of environmental samples.


\textsuperscript{889} In a televised speech former president, Khatami insisted that Iran had no plans to build such weapons: “Iran has discovered reserves and extracted uranium… we are determined to use nuclear technology for civilian purposes.” Khatami quoted in Simmons, \textit{Future Iraq}, p. 176

\textsuperscript{890} It comes as no surprise then that “The United States and international intelligence communities have been unable to paint a full, accurate portrait of Iran’s nuclear program.” George Perkovich, “Changing Iran’s Nuclear Interests,” \textit{Carnegie Endowment for International Peace}, May 2005, p. 2.

\textsuperscript{891} Barnaby, “Iran’s Nuclear Activities,” p. 2.
Iran, often referred to as a “rogue state” and a part of an “axis of evil” by the U.S. government and many American analysts, has been accused by the United States of supporting terrorism, possessing chemical weapons, having a growing nuclear weapons program, and as an enduring threat to Israel, an American ally in the Middle East. Thus, it is not surprising that “[The U.S.] will not tolerate the construction of a nuclear weapon” in Iran. Further, Iran is also hypocritically charged by Washington for abusing human rights and opposing Arab-Israeli peace. When, on 13 December 2002, Iran asserted that its suspect nuclear construction sites were for peaceful purposes, and were fully open to United Nations nuclear experts, the White House expressed great concerns over two secret Iranian nuclear plants, which could be used to produce parts of nuclear weapons. In opposing Iranian nuclear programme, Ari Fleischer, White House spokesperson at the time argued, “There is no economic gain for a country rich in oil and gas like Iran to build costly indigenous nuclear fuel cycle facilities. Iran flares off more gas every year than the equivalent power that it hopes to produce with these reactors.” Moreover, although on 21 February 2003, Iran opened its nuclear sites at Natanz and Arak for inspection by Mohamed El-Baradei and other IAEA personnel, it seemed unlikely that Washington would be satisfied by agency’s findings.

It is clear that the United States and much of the Middle East, would prefer not having to deal with a nuclear Iran, and do not want this to occur. Thus, the U.S. has been considering various strategies to achieve a regime change in Tehran and to prevent Iran from going nuclear: economic sanctions; military action; diplomatic isolation; and the combination of any or all of the above. The regime change is crucial, as some have argued that “The White House … simply cannot wait for the [Iranian] regime to collapse.” For example, in suggesting policy options for Iran, Kenneth Timmerman argues, “We [the U.S.] should empower the pro-democracy forces to change the regime. We should do so openly, and as a government policy,” since the very

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892 Rogue states are those that “brutalise their own people and squander their national resources for the personal gain of the rulers; display no regard for international law, threaten their neighbors, and callously violate international treaties to which they are party; are determined to acquire weapons of mass destruction, along with other advanced military technology, to be used as threats or offensively to achieve the aggressive designs of these regimes; sponsor terrorism around the globe; and reject human values and hate the United States and everything it stands for.” The National Security Strategy of the United States of America (Washington, D.C.: White House, September 2002), p. 14. Iran was mentioned most times as a rogue state by American policy-makers between 1993 and 1998. Paul D. Hoyt, “The “Rogue State” Image in American Foreign Policy,” Global Society, Vol. 14, No. 2, 2000, p. 302.

893 Collective term for rogue states, usually including pre-invasion Iraq, North Korea and Iran. See Jeffrey Record, “The Bush Doctrine and War with Iraq,” Parameters, Spring 2003, pp. 4-21.


897 Mohamed El-Baradei, head of the International Atomic Energy Agency (IAEA), previously said that the sites were not yet operational, but criticised Iran for withholding details of the projects.

898 Such facilities are simply not justified by the needs that Iran has for their civilian nuclear program. Our assessment when we look at Iran is that there is no economic gain for a country rich in oil and gas like Iran to build costly indigenous nuclear fuel cycle facilities. Iran flares off more gas every year than the equivalent power that it hopes to produce with these reactors.

899 Ari Fleischer quoted in Simons, Future Iraq, p. 175.

900 Ibid.
existence of current Iranian regime poses a threat to world security. Moreover, it is commonly argued, “More aggressive actions are deemed necessary” against the “rogues.” According to a U.S. neoconservative Max Boot, “the only way to ensure U.S. security is to topple the tyrannical regimes in Pyongyang and Tehran.... Regime change may seem like a radical policy, but it is actually the best way to prevent a nuclear crisis that could lead to war.”

Pollack and Takeyh argue that Tehran’s course can be changed if Washington and the international community impose sanctions in order to derail Iran’s drive for nuclear weapons. They argue, “The West should use its economic clout to” persuade Tehran to stop its “nuclear program in return for the trade, aid, and investment that Iran badly needs.” Moreover, only if the mullahs recognise that they have a stark choice – they can have nuclear weapons or a healthy economy, but not both – might they give up their nuclear dreams. Arguably, with concern over Iran’s nuclear aspirations growing, the United States and its allies now have a chance to present Iran with just such an ultimatum. If the U.N. Security Council passed a resolution to impose comprehensive economic sanctions without any vetoes, De Bellaigue argues that Iran’s economy would hardly be able to withstand the sanctions.

An alternative way to take action against Iranian nuclear program, according to some analysts would be a pre-emptive, or preventive, U.S./Israeli attack on its nuclear facilities. In this view, despite Iranian leaders’ perception that nuclear weapons would improve Iran’s security, Chubin, Litwak, and Perkovich argue that its pursuit of nuclear weapons actually increases chances of a U.S./Israeli attack, and makes Iran less secure from foreign threats. Hence, these analysts believe that Iranian nuclear weapons pursuit makes very little strategic sense, especially since Saddam Hussein, a major threat to Iran, was removed from power in 2003 and nuclear Pakistan does not pose a threat. There already have been indications that Israel may conduct an attack against Iran. Former Prime Minister Ariel Sharon told the London Times in November 2002 that he would push Iran to the top of the “to-do list” after the war in Iraq. A year later, Israel’s Defence Minister, Shaul Mofaz declared an Iranian nuclear bomb “intolerable” and warned, “[O]nly a few months are left for Israel and the world to take action and prevent Iran from getting nuclear bomb.” Israel has recently been flexing its military muscles in ways not lost on Iranian intelligence, and Iran can have no doubt about Israeli’s willingness to pull the trigger, having witnessed the Israeli Air Force’s destruction of Saddam’s nuclear reactor at Osirak in 1981.

The third option for the U.S. has been to try to isolate Tehran, hoping that the lack of international allies would result in diminished international support for Tehran and foreign investment into Iran. While this attempt mainly targets the E.U.-3 (Germany, France, and the

907 For more, see Arthur Herman, “Getting Serious About Iran: A Military Option,” Commentary, November 2006, pp. 28-32.
909 Stephen Farrell and Robert Thomson, “Iran is a Danger to the Middle East, to Israel, and to Europe,” Times (London), November 5, 2002.
910 Mofaz during meetings with counterparts in Washington, November 2003, as reported by Ma’ariv, November 16, 2003.
U.K.), it is also directed at Japan, Russia, and China. Below, I illustrate this by analysing the U.S. successful prevention of Japanese foreign investment in the Iranian oil industry, hoping that this would lead to a decline in oil production, and that falling export revenues would destabilise the regime. Thus far, this example is the only success that the Americans have had in their attempt to isolate Tehran.

Azadegan

In recent years, the U.S. government managed to coerce Japan into reducing its investment in Azadegan, a very large Iranian oilfield. In 2003, the U.S. government threatened the Japanese that ILSA, which imposes severe penalties on non-U.S. firms that invest more than $20 million in Iran’s oil industry, would be invoked. According to the Japanese officials, the Americans have warned that members of a Japanese consortium might be punished with sanctions if they sign a long-pending deal to develop Azadegan, a big Iranian oilfield. In addition, Richard Boucher, the State Department’s spokesperson, said in 2003 that this was a “particularly unfortunate time” to be striking deals with Iran.

Some Japanese officials, particularly in the Foreign Ministry, agreed with Boucher. They appreciated America’s muscle as a deterrent to a nuclear-armed North Korea, and did not want to give the impression that they are indifferent to Iran’s nuclear program, civilian or otherwise. However, others, who possessed more influence at the time, pointed that given its close alliance with the U.S., Japan had a stake in trying to moderate U.S. policy towards the Middle East, and therefore to protect its economic investment in the region. Other Japanese diplomats were opposed to Japan pulling out of big Iranian investment by pointing to the deal’s financial size (it could have been worth as much as $2.8 billion) and to Japan’s quest for secure oil supplies. Thus, Iran was advanced $3 billion in loans in return, though neither side would put it that way, for giving the Japanese consortium exclusive negotiating rights.

After the election of moderate president Khatami in Iran in 1997, and the lack of any change in Washington’s hardline policies toward Tehran in the months and years that followed, Tokyo began to grow increasingly uncomfortable with the American line, and as a result, by 1999, the Japanese government began to seek closer relations with Tehran. In the following months and years, relations between Tokyo and Tehran improved rapidly, so when in February 2000 the Japanese-owned Arabian Oil Co. lost its long-term concession in Saudi Arabia, Japanese officials considered Iran as a suitable alternative. Tehran was pleased with Japanese interest, as its

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911 Azadegan was discovered in 1999, representing Iran’s largest oil discovery in 30 years, and is located onshore in the southwestern province of Khuzestan, a few miles east of the border with Iraq. Reportedly, Azadegan contains proven crude oil reserves of 26 billion barrels, but the field is also considered geologically complex, making the oil more challenging and more expensive to extract. In January 2001, the Majlis approved development of Azadegan by foreign investors using the “buyback” model. “Iran Country Analysis Brief.”
913 Ibid.
914 Ibid.
916 “Will America Invoke Sanctions?”
917 This was symbolised by Japanese Foreign Minister Komura Masahiko’s visit to Iran in August 1999, and the resumption of yen loans. Suvendrini Kakuchi, “Tokyo Warms to Iran, Despite US,” Asia Times, August 14, 1999.
918 In November 2000, President Khatami visited Tokyo and announced that his government would give Japan preference in negotiations over the development of Azadegan oil field. Japanese Ministry of International Trade and Industry’s (MITI) Minister Hiranuma Takeo was enthusiastic about this project, and pledged to work closely with
objective was to conclude negotiations and sign the agreement to develop Azadegan as soon as possible.\textsuperscript{919} While Washington applied some pressure, Japan was successful in handling it.\textsuperscript{920}

Then came 11 September 2001, and suddenly, Tokyo began placing much greater emphasis on the U.S.-Japan security alliance, and became more fearful of doing anything that would have annoyed Washington at that volatile time. Matters became even worse when President Bush, in his January 2002 State of the Union speech, identified Iran as one of the countries that support terrorism and included it in his “axis of evil.” At this time, the Japanese-Iranian negotiations continued, but at a very casual pace. Tokyo was now not in a hurry to close the deal.\textsuperscript{921} Finally, by June 2003, the business negotiations were more-or-less complete, and all that had to be done was to seal the agreement. Tokyo had kept Washington informed, and so just before the deal was to be signed, the Bush Administration launched a diplomatic offensive on Tokyo. National Security Adviser Condoleezza Rice, Secretary of State Colin Powell, and Deputy Secretary of State Richard Armitage threatened Tokyo: Signing this deal with Tehran could damage the U.S.-Japan alliance.\textsuperscript{922} They brought up the nuclear issue in Iran as a main concern, and in addition, pointed that Iran supported terrorists and had close relationship with North Korea.\textsuperscript{923}

Therefore, Japan was inclined to continue delaying, but in early July 2003, Iranian Foreign Minister Kamal Kharrazi released a statement that if Japan failed to act, then Iran would begin negotiating with China, India, and/or Russia on the Azadegan deal. Tehran reminded Tokyo that they had other options. At the same time, however, Tehran said that they still preferred Japan to other candidates, and that they would not give up on the negotiations.\textsuperscript{924} In August 2003, Kharrazi visited Tokyo and urged Japanese leaders to defy the U.S. pressure.\textsuperscript{925}

All along, one of the key men pushing for Japan to move ahead with the Azadegan deal was MITI Minister Hiranuma, who was in September cabinet reshuffle replaced by Nakagawa Shoichi, a rightwing nationalist, who was very sceptical about Iran. With the departure of Hiranuma, the Azadegan deal lost a key ally on the Japanese side. Aggravated with Japan’s delays, Iran set a 15 December 2003 deadline. If Tokyo failed to clarify its intentions by that point, Tehran would begin negotiations with other countries.\textsuperscript{926} However, Japan let the deadline pass, without taking any action. Nakagawa’s policies of damaging Japan’s relations with Iran were heavily criticised at home, and these heavy criticisms had some effect. In addition, in early 2004 Japan sent 550 of its Self-Defense Forces (SDF) to Samawa, Iraq, in accordance with Washington’s strong wishes and this may have made Tokyo feel more secure about defying the

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\textsuperscript{920} One Japanese official commented in August 2001: “We are not sure if the U.S. administration will apply the Iran-Libya Sanctions Act [ILSA] to Japan’s development of the Azadegan oil field. But we remain opposed to taking a sanctions policy toward Iran … If the U.S. punishes Japanese firms under ILSA, Japan may consider filing a complaint with the World Trade Organisation against the U.S. measures.” Cited in ibid.

\textsuperscript{921} Hisane Misaki, “No Hurry over Iran Oil Deal: Meeting Target Date Could Have Strained U.S. Relations,” \textit{Japan Times}, February 22, 2002.


\textsuperscript{926} “Iran Sets Deadline for Talks on Oil Development Project,” \textit{Japan Times}, December 9, 2003.
Bush administration on Iran. Additionally, Iran’s negotiations with the IAEA were improving at the time. Therefore, on 18 February 2004, a Japanese consortium led by Inpex finally went ahead with the $2 billion Azadegan deal and signed the agreement.927

While Richard Boucher criticised the deal, oddly, the hardline official, John Bolton, who was in charge of this issue in Washington, was not too harsh.928 This may have reflected the fact that Washington was resigned to the eventuality of the deal, and that, in any case, U.S.-Japan relations were very strong at the time, especially with Japanese involvement in Iraq. Washington tacitly acknowledged the Iran deal was a *quid pro quo* for Iraq.929 Even though the Bush administration did not push very hard, some commentators did attack the deal, arguing that Tokyo was making a mistake that could seriously damage the U.S.-Japan alliance.930

Even after Azadegan deal was signed, its future remained in doubt, as Inpex, which held the development contract, has been accused of missing a series of deadlines on the scheme, amid suspicions that the Japanese NOC was buckling under US political pressure to exit.931 In August 2004, Washington prodded Tokyo to cancel the deal and pursue oil interests in Libya instead, but Tokyo did not accept this offer.932 However, the balance of forces that supported the February 2004 deal was weakening. One of Japan’s main arguments all along was that engagement with Tehran would help moderate forces make positive changes in Iran. The election of President Mahmoud Ahmadinejad in June 2005 seriously damaged that line of argument. In relations, the new political flare-up over Iran’s nuclear program was negative for Japan-Iran relations. Both of these events put Tokyo’s policy under serious strain by the U.S. pressure. Thus, in March 2006, U.S. Deputy Secretary of State Robert Zoellick had “informally” asked Tokyo to write off its investment in Azadegan.933 It is worth noting that by mid-2006, the threat of ILSA had shaken up some Japanese business leaders, and Japan has curbed its oil imports from Iran by 20 percent.934

Michael Penn notes that the deployment of Japanese troops to Iraq “was motivated more by Japan’s insecurity toward China and North Korea than by Japan’s policy toward Muslim nations. Because of Japan’s feeling of insecurity in East Asia, they felt that it was necessary to align more closely with U.S. policy in the Islamic world.”935 If Japan aimed at getting closer to the U.S., it is very doubtful this would have happened if it invested heavily in Iranian oil. Hence, what happened in early October 2006 came as no surprise. Japan’s inaction and its inability to stay in the game resulted in its Azadegan oil concession reduced from 75 percent to 10 percent. After lengthy negotiations, Inpex agreed to transfer the stake to NIOC, and as a result, the status of the project operator moved to the Iranian side, while Inpex became a minority partner.936

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927 “Japan Ignores U.S. Pressure, Will Develop Iranian Oil Field: Proliferation Policy Said Intact Despite $2 Billion Deal,” *Japan Times*, February 20, 2004. Inpex, which has no upstream experience of its own, hoped to bring in an international partner – possibly France’s Total, Norway’s Statoil, China’s Sinopec, or Russia’s Lukoil (Shell has indicated that it is not interested) – as the field’s operator. It was hoped that the initial production of medium-sour crude oil from Azadegan could come in 2007, ramping up to 250,000 bpd by 2009 and 400,000 bpd in the long term. At its peak, Azadegan production was expected to account for as much as 8 percent of Japan’s oil imports.
931 “Between a Rock and a Hard Place.”
935 Quoted in ibid, p. 29.


The Limitations of U.S. Actions

Options available to the U.S. in order to achieve a regime change in Tehran with the ultimate goal of ending Iranian pursuit of nuclear weapons, which range between economic sanctions, military attacks, and/or diplomatic isolation (as illustrated above), at first glance offer much hope for success in Washington. However, this is not the case, and that there are various issues concerning all of these options, which make them, and will likely continue making them, ineffective.

Firstly, sanctions against Iran are not likely to be effective. According to Scott Sagan, “as Washington learned with India and Pakistan in the 1980s and 1990s, sanctions only increase the cost of going nuclear; they do not reduce the ability of a determined government to get the bomb.”937 IAEA chief Mohamed ElBaradei, said sanctions against Iran were “a bad idea,”938 as even if multilateral sanctions are imposed against Iran, their effectiveness would be extremely questionable, especially given history of ineffectiveness of ILSA in particular, and of sanctions in general. They often fail to deliver the desired effect, and result in even worse situation. In addition, should comprehensive sanctions be imposed, the result could well be that Iran, similar to North Korea in 2003, would renounce the NPT and end all IAEA inspections,939 and if Western pressure over its nuclear program increases in future, the Iranians have already threatened with this cause of action.940 Leaving the NPT is allowed under the treaty941 and it allows a state to develop nuclear power and nuclear weapons without inspections.942 Several states with nuclear weapons, Israel, India and Pakistan, never joined the treaty, and according to some critics, the NPT has been under considerable pressure in recent years due to the U.S. failure to maintain and improve, but rather undermine the NPT.943 Moreover, the U.N. Security Council’s imposition of comprehensive sanctions is unlikely since permanent members of the U.N. Security Council, Russia, and primarily China, are opposed to any sanctions against Iran. Russian Foreign Minister Sergei Lavrov said his country remained opposed to sanctions against the Islamic Republic, and China remained committed to diplomatic solution.944


939 Precht, “War with Iran,” p. 34. In April 2007, Ali Larijani, Iran’s chief nuclear negotiator with the West, warned that Iran would have no choice but to review its membership of the NPT if further pressure was applied by the West over its nuclear programme. Cited in “Iran Nuclear ‘Landmark’ Angers US,” BBC News, April 10, 2007, http://news.bbc.co.uk/go/pr/fr/-/2/hi/middle_east/6540083.stm, [April 10, 2007].

940 “Iran Threat to Quit Atomic Treaty,” BBC News, May 7, 2006, http://news.bbc.co.uk/go/pr/fr/-/2/hi/middle_east/4981940.stm, [May 9, 2006]. Unless the row over Iranian nuclear program was resolved peacefully, Iranian parliament would, according to the MPs’ statement, “have no choice but to call on the government to retract its signature of the Additional protocol and to place on its agenda an examination of Article 10 of the NPT.”

941 “Each party shall in exercising its national sovereignty have the right to withdraw from the treaty if it decides that extraordinary events, related to the subject matter of this treaty, have jeopardised the supreme interests of its country.” Article 10, Nuclear Non-Proliferation Treaty.

942 “Iran ‘Could Quit Nuclear Treaty’.”


944 See ibid.
Secondly, military action is by no means an attractive option, and reasons are plentiful. An attack on Iran’s prime nuclear site, the Bushehr nuclear power station, could have Chernobyl-level consequences stretching to Saudi Arabia, Kuwait and the U.A.E., all American allies. Precision attacks on suspected Iranian nuclear facilities would most probably cause Tehran to seek a deterrent against further pre-emptive or preventive attacks by Washington and/or Tel Aviv. In case of such an attack, Tehran could use its capabilities to stir violence and instability in Shi’a dominated areas of Iraq, where Iran carefully cultivated its influence, as its intelligence skilfully organised the Iraqi Shi’a population after Desert Storm. For example, according to David Francis, “Iran could instruct its operatives in Iraq to sabotage Iraqi oil exports from the port of Basra. Shi’as are the dominant religious group in both Iran and southern Iraq. That would reduce world oil supplies by about 1.1 million bpd, a drop of 1.3 percent.” Additionally, Iran may also try to block oil shipments through the Strait of Hormuz, threatening vital oil exports from Saudi Arabia, Kuwait, and other Gulf states. Finally, Iran can play the global terror card, and groups tied to Iran (Hezbollah in particular, not Al-Qaeda), continue to have robust capabilities and could cause a lot of instability over the short term.

Pre-emptive and preventive military strikes by either the United States or Israel in the name of counter-proliferation would be a political catastrophe of major proportions for U.S., regional, and global security. Such cause of action would raise Israel to ‘enemy No. 1’ in Iranian threat perceptions, which is much worse than the current Iranian perception of the United States as the main enemy. Even worse, a strike by Israel could make the Iranian bomb an Islamic bomb in the perceptions of Arabs and Muslims worldwide, making the current bilateral animus between Israel and Iran a global and regional security issue. In addition, analysts suggest that a unilateral Israeli attack would be “very high risk,” making it almost prohibitive. To get to Iran, Israeli planes would have to fly over Saudi Arabia and Jordan, probably a casus belli in itself, given

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949 Francis, “Why Iran Oil Cutoff Could Be Suicidal.”

950 For more see Lang and Johnson, “Contemplating the Ifs,” p. 29.

951 Ibid.


current political conditions; or over Turkey, also a problem; or over American-controlled Iraq, which would require U.S. approval of the mission. Further, Russia, China, and the European Union are committed to peaceful resolution of Iran’s nuclear problem, and do not support military action against Iran. There are no legal reasons, which would allow the international community to conduct a large-scale military operation or to take a limited military action against Iran; thus, a possibility of creating an international coalition is practically excluded. Hence, it would be a “war in splendid isolation.”

Military options are not logistically feasible or politically prudent in the context of high oil prices. Moreover, since they would be “costly, ineffective and counterproductive,” they are “currently not credible.” For example, any attack on Iran at times when prices of oil are at almost record levels, would result in decline in Iranian production and exports, which would in turn have a positive effect on the oil prices, bringing them up considerably. Neither any of the oil producing states nor the U.S. through its release of strategic reserves would be able to compensate for the loss of Iranian oil. For this reason, military options at times when oil prices are high are unwise.

Even if a full-scale war were launched against Iran, it would not be won as easily as that against Iraq. Iran has 800,000-strong army, people’s guard of several million men and officers, and ballistic missiles that can threaten the region, including the strategic Strait of Hormuz, U.S. military bases, Israel, oil export facilities in Saudi Arabia (Ras Tanura and Yanbu), and Europe. Iran is ready to use this power in case military action against it is imminent, and in the event of an attack, Tehran has vowed to retaliate with devastating consequences. According to Amin Saikal, “given that the Iranian regime is far more resourceful, resilient and stubborn that that of Saddam Hussein, with a willingness to wear the risk of a confrontation irrespective of its damage to Iran, its threat of retaliation has to be taken seriously.” Further, full-scale military action against Iran is not recommended because Iran is about four times the size of Iraq and its cities are isolated across vast deserts, and its population, three times that of Iraq, is 90 percent Shi’a, and has historically remained united in times of great stress and is intensely proud and nationalistic.

In case of military strikes on Iran, Kenneth Timmerman argues that not all of Iran’s hidden nuclear assets would be taken out, as pre-emptive strikes are unlikely to be very effective. Israeli air force flattened Iraq’s Osirak nuclear reactor in 1981, and one could suspect Israel to attempt a similar mission against Iran. However, Iran has learnt from that episode, as it has dispersed, hidden and buried its numerous facilities. Some sites, including Natanz, are up to 25 meters underground. Additionally, Western intelligence agencies are not confident that they

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955 Timmerman, Countdown to Crisis, p. 312.
956 Ibid, p. 313.
962 Timmerman, Countdown to Crisis, p. 313.
964 “When the Soft Talk has to Stop,” The Economist, January 14, 2006, p. 32.
know enough about Iran’s nuclear program to ensure that all the relevant sites are hit. Moreover, even if the important targets were destroyed, Iran is so advanced in its program that it could recover the lost time relatively quickly, within one to five years. All of the above factors make military option against Iran unfeasible. Richard Betts argues, “Military action might at best suppress Iran’s nuclear ambitions temporarily; at worst, and no less probably, an attack could make them more intense and more dangerous.” At best, a military strike would set back Iran’s program a few years, inflame public opinion there and unify the nation in its bid to go nuclear.

Eventually, if either comprehensive economic sanctions are imposed against Iran, or if there is a military attack against its nuclear facilities, Iran would most likely retaliate by using the ‘oil weapon’, what would in turn cause havoc on world oil markets. For example, in 2005 Iranian officials claimed, “Oil could be used as a weapon to get its own way on nuclear issues.” In early March 2006, Iranian Interior Minister Mostafa Pourmohammadi supported this cause of action by arguing, “If they [the U.N. Security Council] politicise our nuclear case, we will use any means. We are rich in energy resources. We have control over the biggest and most sensitive energy route of the world… No means [for reprisals] will be ignored and we will not disregard any means.” Iranian intentions against those voting for sanctions before the U.N. Security Council are clear: “Iran will review its oil contracts,” said Iranian Oil Minister Kazem Vaziri-Hamaneh, when asked about the consequences of possible sanctions. In relation, on 14 March 2006, Iran threatened targeted oil boycotts against countries that support U.N. sanctions against it, and “by talking of cutting its oil exports in retaliation [to economic sanctions], Iran helped talk up the market price of oil. A cut in supplies could send it far higher.” Many argued that any sanctions against Iran or any threat to Iran’s exports of crude oil could push the price of oil to $100 a barrel, what surpassing the level reached during the oil shocks of 1973 and 1979, when adjusted for inflation. Pierre Terzian confirmed this view: “There are no sanctions on the oil sector in Iran that will not hurt the whole world at the same time.”

In early June 2006, Iran’s supreme leader, Ayatollah Ali Khamenei, threatened to block oil from leaving the Persian Gulf if Iran’s security was in danger: “Beware, if you make the slightest mistake over Iran, the energy flow through this region will be seriously in danger.” In relation, Christopher Dickey argues, “[A]ny misstep in the campaign to deter Iran from developing nuclear technology that might be used for an atomic bomb could lead to an explosion in the cost of oil.” Ian Bremmer adds that despite the fact that this “would badly damage its own economy”, “Iran’s threat to pull oil off the market is not an empty one, in part because the

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964 Ibid.
967 David Thurtell quoted in “Iran Nuclear Tensions Drive Oil and Gold Higher,” The Straits Times, February 13, 2006.
971 “All Still to Play for,” The Economist, January 21, 2006, p. 46.
973 Quoted in Dickey, “The Oil Shield.”
975 Christopher Dickey, “The Oil Shield,” Foreign Policy, no. 154, May/June 2006, p. 38.
regime has few other weapons at its disposal.” Thus, Iran’s calculus is essentially zero-sum, positing that Iran would be willing to accept pain in order to inflict it. If Iran takes 200,000 to 300,000 bpd (around 10 percent of its exports) of the oil market, oil markets would react not only to the fall in supply but also to fears of what Tehran might do next, and therefore, taking Iranian oil and gas exports out of the world market is something many countries would like to avoid.

All of the above gives a little less force to any parties pushing for economic sanctions or a military option. While sanctions would most likely be ineffective, fighting Iran would be bloody and endless. In such scenario, oil prices, which are already at almost record levels, would skyrocket. Washington and Israel would most likely stand alone in the world without even the “coalition of the willing” President Bush boasts of in Iraq. Finally, it is questionable whether Iran’s nuclear programme would be stopped, and even if it were slowed down, Iran would likely be even more determined to develop nuclear weapons in future. Below, I discuss the last U.S. option, diplomatic isolation, and assess whether it has been successful and if it is likely to be successful in future.

One of the main goals of Iranian foreign policy “is to counter U.S. efforts to isolate it.” This goal is influenced by the overarching objective of domestic regime stability, and is based on positive economic and/or military relations with other important powers, the E.U., China, India and Russia, which can help Tehran to balance the American threat. Thus, in recent years Iran has searched for and found strategic partners willing to accept its activities and willing to deal with it on a quid pro quo basis. For example, Iran’s carefully cultivated relationships with China and Russia are according to Sanam Vakil, “providing it with the economic and political coverage that it could never obtain from the West.” China will resist pressuring Iran concerning its nuclear program, and will seek to guarantee the availability of energy supplies. Russia will also resist calls for sanctions against Iran. Thus, after Japan exited the Azadegan deal, the Iranian Government was left with alternative options. Tehran previously suggested that if Japan exited the Azadegan deal under the threat of the ILSA, and did not begin work on the field by 22 September 2006, then China or Russia will be happy to step in. Indeed, diplomatic and trade ties between Iran and China, and Iran and Russia have been very close, and it is very likely that China or Russia will become the ultimate beneficiaries of Japan’s efforts in Azadegan. Below, I examine Iran’s close relationship with China and Russia, but also with India and the E.U.-3, other important powers used to counterbalance the U.S. effort to isolate Tehran.

China

Although the Sino-Iranian relationship has long and deep historical roots, China and Iran established diplomatic relations only in 1971, and became strategic allies as a result of Chinese arms sales in the 1980s. Despite the fact that both nations have experienced revolutionary

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979 Ibid, p. 22.
982 This possibility has been suggested in “Iran Plays China Card with Japan on Oil Deal,” *Japan Times*, May 26, 2006; “Iran Hints Suitors Set to Replace Inpex,” *Japan Times*, June 1, 2006; “Iran Eyes Russia, China if Japan Stalls on Oil Deal,” *Japan Times*, August 29, 2006; and “Between Rock and a Hard Place.”
change in the intervening decades, their continued relationship demonstrates that both countries value political pragmatism, strategic imperatives, and economic trade above discrepancies in ideology and religion.\footnote{The two countries share a similar narrative as historically great civilisations whose progress toward modernity was retarded by Western infringement, but the friendship is also built on commercial interests and a mutual commitment to a multipolar world to blunt U.S. influence.} The two countries share a similar narrative as historically great civilisations whose progress toward modernity was retarded by Western infringement, but the friendship is also built on commercial interests and a mutual commitment to a multipolar world to blunt U.S. influence.

Iran views its friendship with China as vital to its continued ability to resist pressure from the West and endure sanctions.\footnote{Douglass, Nelson and Schwartz, “Fueling the Dragon’s Flame,” p. 5.} Meanwhile, China sees Iran as a major player in the Middle East, and a strong partnership with Iran has enhanced China’s capacity to become an important player in regional affairs.\footnote{For more on historical roots of Sino-Iranian relationship, see John Calabrese, “China and Iran: Mismatched Partners,” The Jamestown Foundation, Occasional Paper, August 2006, p. 3.} In early 2007, Iran was China’s primary source of oil, and on average, it supplied 15 percent of China’s annual oil imports.\footnote{Douglass, Nelson and Schwartz, “Fueling the Dragon’s Flame,” pp. 2 and 6.} Beijing’s unquenchable thirst for oil supplies explains the ambitious Memorandum of Understanding that Iran and China (through Sinopec) signed in October 2004. Under this agreement, China may buy between $70 billion and $100 billion of Iranian oil and natural gas over the next 30 years, while developing Yadavaran, Iran’s biggest onshore oilfield, and South Pars fields in the Persian Gulf, the largest natural gas reserve on the planet. On signing the deal, Iran’s Petroleum Minister announced that Tehran would like to see China replace Japan as Iran’s largest oil importer.\footnote{For more on this relationship, see Calabrese, “China and Iran: Mismatched Partners”; Douglass, Nelson and Schwartz, “Fueling the Dragon’s Flame,” pp. 5-10; Howard, Iran Oil, pp. 88-104; J. Brandon Gentry, “The Dragon and the Magi: Burgeoning Sino-Iranian Relations in the 21st Century,” The China-Eurasian Forum Quarterly, November 2005; John W. Garver, China and Iran: Ancient Partners in a Post-imperial World (Seattle: University of Washington Press, 2006).} In addition, the two countries agreed to construct a pipeline in Iran to take oil 386 km to the Caspian Sea to link up with the pipeline from China to Kazakhstan.\footnote{See Tian Hui, “Energy Drives China to Big Iran Market,” Oriental Morning Post, June 28, 2005 (author’s translation) and David Harman, “China’s Crude Oil Import Rises 3.5% in January,” Resource Investor, March 1, 2007.} It is no accident that Iran signed these agreements with a permanent member of the U.N. Security Council, which the United States would like to use to sanction Iran for its nuclear activities. After signing major energy deals with Iran, China would not respond to U.S. pressure, what makes it a very attractive business partner for Tehran. Illustrative of this is that after these agreements had been signed, Li Zhaoxing, the Chinese Foreign Minister, paid a visit to Iran, and stated that China saw “no reason” to refer Iran’s nuclear program to the U.N. China is reluctant to see any U.N. measures that prevented access to Iran’s oil and gas, and is a major obstacle in any attempt by the U.S. to get sanctions imposed.\footnote{Engdahl, “China Lays Down Gauntlet in Energy War.”}

Iran’s importance in Chinese foreign policy is evident in comments made by a Chinese scholar: “Iran is the key to the Gulf’s security and stability … China must strengthen its economic and political ties to Iran.”\footnote{Zhang Xiaodong, “China’s Interests in the Middle East: Present and Future,” Middle East Policy, vol. 6, no. 3, February 1999, p. 150.} According to Dingli Shen, “Tehran is an energy source that Beijing cannot refuse and the protection of China’s energy relationship with Iran is of vital importance.”\footnote{Diengli Shen, “Iran’s Nuclear Ambitions Test China’s Wisdom,” The Washington Quarterly, vol. 29, no. 2, Spring 2006, p. 62.} David Lampton and Richard Ewing suggested that Beijing values its ties to Tehran highly enough to allow it to cause genuine strains in the Sino-American relationship.\footnote{Lampton and Ewing, The US-China Relationship, p. 26.}
China’s relationship with Iran is Beijing’s deepest and most substantial bilateral relationship in the region. 995 Meanwhile, “China occupies an important position in Iranian foreign policy,” 996 as it mitigates the impact of U.S. imposed restrictions on Western investment in Iranian oil industry. 997 According to an Iranian oil industry official, “China and Iran are perfectly matched for each other,” as “China has the world’s biggest market of customers and no secure resource for energy. We have a lot of energy, and we need foreign currency. And they have a lot of money to invest. It’s a win-win situation.” 998 Clear signs of close bilateral relationship between Beijing and Tehran were obvious when Chinese President Hu Jintao was among the first to congratulate Iran’s new conservative president Mahmoud Ahmadinejad on his election victory in June 2005.

In return for oil and natural gas, Iran imports manufactured goods from China, including computer systems, household appliances and cars, and awarded China the right to build a fleet of super-tankers that will transport oil to China. Iran also promised to provide funds to upgrade China’s refinery capacity to process Iranian crude. 999 Moreover, in recent years China built power plants, cement factories and joint shipping lines in Iran. 1000 There are an estimated 250 Chinese companies engaged in various projects or else selling low-cost consumer products in Iran. 1001 However, it is in terms of arms sales that links have been the strongest. Tehran found Chinese arms to be of good quality and cheaper than arms available from other sources. As a result, China quickly became Iran’s foremost supplier of military equipment. 1002 Beijing supplied Tehran with $800 million worth of conventional weapons between 1995 and 2002. 1003 This relationship grew over the years, including Tehran’s purchase of Chinese C-801 and C-802 anti-ship Silkworm missiles. It was after this sale that Washington began to worry about shipping traffic in the Strait of Hormuz and the safety of U.S. naval forces and general tanker traffic.

In addition, Beijing negotiated deals to supply Iran with equipment and technology useful for making nuclear, chemical and biological weapons, despite having signed international agreements prohibiting the proliferation of such technologies. 1004 Beijing began assisting Tehran’s nuclear program in the early 1990s, supplied Tehran with several research reactors, and expanded nuclear

995 Ibid. p. 25.
1004 Barry Rubin shows that China has violated its commitments under the Missile Technology Control Regime (MTCR) by supplying Iran with unconventional long-range missiles. China acted against the NNPT by supplying Iran with equipment and technology useful for making nuclear weapons. Finally, by selling chemical precursors, production equipment and technology to Iran, Beijing violated the Chemical Weapons Convention. Rubin, “China’s Middle East Strategy,” p. 4. Also see Timmerman, Countdown to Crisis, pp. 119-20, 130.
cooperation with Iran well beyond the limits of purely civilian research and technology. In 2003, Gholamreza Aqazadeh, the head of Iran’s Atomic Energy Organization, stated that Iran imported 1,800 kilograms of uranium hexafluoride gas from China in 1991, before China joined the NPT regime. If Iran is today well on its way toward an indigenous nuclear-weapons capacity, then it is thanks in no small part to Beijing.

China’s cooperation with Iran did not go unnoticed in Washington, and Beijing has been encouraged to pressure Iran to surrender its nuclear ambitions. However, China feels little threat from Iran’s nuclear program, and is unlikely to ignore the UNOCAL case (see Chapter 5), when American strategic interests prevented CNOOC from acquiring that mid-sized oil independent. Bill Powell highlighted the crucial importance of China’s decision in the implication of possible U.N. sanctions: “For whether the world stands any chance of eventually imposing sanctions that might get the mullahs’ attention will be decided in China, by President Hu Jintao and the leadership of the Chinese Communist Party.” It is easy to predict Beijing’s decision, as it will “not support a largely Western action to sanction Iran,” and will use its veto power to prevent sanctions against Iran in case they are on the U.N. Security Council agenda. In similar manner, China has in past blocked Council action against Sudan because of its oil interests there, despite the genocide in Darfur. The same day that Iran was given a one-month deadline to end uranium enrichment or face possible sanctions, China’s head of central planning, Ma Kai, was in Tehran trying to finalise plans for Sinopec to develop Yadavaran oil-field.

Russia

Besides China, Iran also uses Russia’s support to balance the U.S. attempt at isolation. Since 1995, Russia has been the primary supporter of Iran’s nuclear program. This support was so evident that “stopping Russian assistance to Iran’s nuclear program was a high priority for the U.S. throughout much of the 1990s.” Despite a long-standing history of Russian meddling in Iran, bilateral ties today are at their highest level since World War II. Russia’s experience with Iran, whether in Tajikistan, where the two countries cooperated to end a brutal civil war, and elsewhere in the former Soviet domain, where Iran abstained from fomenting Islamist revolutions, or with respect to Chechen separatism, which Iran has de facto condemned, has been largely positive.

Alexander Maryasov, a long-standing Russian ambassador to Tehran...
argues, “We [Russia] are in agreement with Tehran that no other great foreign power should gain influence in the Caspian Sea,” and Russia and Iran are likely to expand cooperation based on these “identical views.”

This cooperation is, for example, evident in the fact that in the 1990s Iran cooperated with Russia in the development of the Caspian energy fields. In addition, while suspicious of U.S. and Turkish designs on the region, the two countries worked to thwart the U.S.-backed Baku-Tbilisi-Ceyhan (BTC) pipeline, as by coordinating with Gazprom, NIOC lowered the price of oil swaps with Turkmenistan, Kazakhstan, and Azerbaijan. However, their joint efforts to thwart the importance, and prevent the construction of BTC pipeline were unsuccessful. Moreover, more recently, it has been suggested that Iran and Russia are working on preliminary plans to establish a “Natural Gas OPEC,” with the ultimate goal of blocking European efforts to diversify sources of their natural gas imports.

Based on close cooperation, some have even gone so far as to suggest that Russia and Iran reached a strategic partnership abiding by their interests. A more plausible view of Russo-Iranian relationship is offered by Ray Takeyh, who argues, “During the past decade, a tacit yet important bargain has evolved between Russia and Iran.” In this bargain, on one hand, Iran has emerged as Russia’s most important partner in the Middle East and as a valuable market for its cash-starved defence industry. On the other hand, Iran has kept a low profile in Central Asia and has refrained from destabilising a region critical to Russia’s security. According to Takeyh, this important relationship has “led Moscow to provide Iran indispensable diplomatic support, particularly at a time when its nuclear portfolio is being addressed in a variety of international organisations.”

Russia, together with China, is one of Iran’s most important weapons suppliers, and Russian arms deliveries to Iran are a key aspect of the close relationship, which itself has been described as “one of the most important geopolitical episodes of the post-Cold War era.” Between 1991 and 2001, Russia has supplied $3 billion worth of modern weapons to Iran. In December 2005, Russia confirmed a deal to sell 30 surface-to-air (Tor M1) missile systems to Iran for $1 billion, drawing criticism from the United States and Israel. These missile systems are capable of protecting a target from up to 48 incoming planes or projectiles to a range of six kilometres. The Tor M1 purchase is just the first stage of a more comprehensive Iranian purchasing program, as there are ongoing talks between Moscow and Tehran to purchase S-300 strategic air-defence systems.

Work,” Middle East Policy, March 2001; Kaveh L. Afrasiabi, “Russia Plays a Double Game Over Iran,” Asia Times, November 4, 2006; and Takeyh, Hidden Iran, p. 78.


1018 Magomedov, “Russia’s Policy Toward the Caspian Sea Region and Relations with Iran,” p. 17. Besides, Russia, through Gazprom, purchased stakes in several natural gas industry companies in Libya, and signed a wide-ranging cooperation agreement with Sonatrach, the Algerian NOC, after Russia forgave Algeria’s $4.7 billion debt. Besides Iran, Algeria and Libya are precisely the supplier countries that the Europeans named as possible alternative sources of supply to Russian gas.

1019 Pepe Escobar, “Russia and Iran Lead the New Energy Game,” Asia Times, July 20, 2006. For more on Russo-Iranian relationship, see Howard, Iran Oil, pp. 104-11.

1020 Takeyh, Hidden Iran, pp. 78-9.


system, which has a range of 150 km and is one of the most sophisticated in the world. Russia has also agreed to upgrade Iran’s small fleet of MiG-29 interceptor planes to make them more effective against enemy aircraft.

Further, Russia works to complete the Bushehr light-water nuclear reactor, which is to be operational by November 2007, and views Iran as a lucrative market for its civilian nuclear industry. In February 2005, Moscow and Tehran concluded an agreement under which spent nuclear fuel from Bushehr would be shipped back to Russia. In September 2005, Russia, together with China, abstained in the IAEA vote, which declared Iran in violation of its NPT commitments for having hidden its enrichment work, thus clearly showing their support for Iran. In addition, in late March 2006, both countries refused to have Iran’s nuclear activities declared “a threat to peace and security” at the U.N. Security Council, since this could open the door to tougher action in future. Moreover, the Putin government has maintained that Russia would not support U.N. Security Council resolutions that condemn Iran’s nuclear energy program or apply economic sanctions against Iran. To the Kremlin, Iran has been a well-behaved neighbour, which has kept out of Chechnya, and the Russians want to keep it this way. Russia also benefits from any speculation of Middle Eastern instability (particularly concerning the Iranian nuclear program), that keeps oil prices high. Likewise, if not constrained, a part of Iran’s agenda is to drive oil prices even higher, and one can see a lot of mutual interest.

India

As part of Tehran’s eastern diplomatic offensive, it has built solid trade relations with India and is pursuing a common policy in Central Asia, a key strategic region. In January 2005, the state run Indian Oil Corp. (IOCorp) reached an agreement with the Iranian firm Petropars to develop a gas block in the gigantic South Pars gas field, home to the world’s largest reserves. At the same time, India is cooperating with Iran on securing Persian Gulf sea-lanes and is helping develop Iran’s Chahbabar port into a regional hub. In addition, there has been a rapid expansion in energy ties. Iran and India are currently engaged in a joint project to build a gas pipeline that would also cross Pakistan. Dubbed the “peace pipeline”, the $4.5 billion project could cement relations between Iran, India and Pakistan. Unsurprisingly, Washington signalled its displeasure with India’s collaboration with Iran when U.S. Secretary of State Condoleezza Rice stated that Washington had concerns over the pipeline deal. In a rare snub to Washington, and

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1027 “Russia is not a Piece of Furniture,” The Economist, April 22, 2006, p. 47.
after beginning to realise that links with Tehran translate into diplomatic coin in Washington, India responded by saying that long-term energy security, not politics, would dictate its energy policy.\textsuperscript{1032} “I think that there are a number of companies working in Iran, including a large number of European companies,” Indian Petroleum Secretary S. C. Tripathi said. “A large number of countries are having economic relations with Iran, therefore it should be possible for us also to work out a reasonable and well-drafted and well-crafted hydrocarbon agreement with Iran. I think it should be possible.”\textsuperscript{1033}

The Indo-Iranian relationship has much more to it than simple oil and gas interests. India and Iran, similar to China and Iran, have cultivated limited military relations, conducting a joint naval exercise in March 2003 that was motivated on Tehran’s part by the U.S. naval presence in the Persian Gulf. Iran is also seeking India’s help for servicing its naval and air-force equipment, including its MiG-29 jets. According to a recent CSIS report, “Iran’s Developing Military Capabilities,” Tehran sought India’s help in developing batteries for submarines, which are more suitable for the warm waters of the Gulf than those supplied by Russia. Unlike Beijing, anxious not to antagonise Washington, New Delhi has been cautious in keeping its distance from Iran on the nuclear issue, although it has claimed to help Tehran with generating nuclear energy.\textsuperscript{1034}

\textbf{The E.U.-3}

The European countries’ policy toward Iran differs from that of the U.S.\textsuperscript{1035} For example, when the Clinton administration decided in 1995 to impose sanctions against investments in Iran, the American action pushed the Europeans to make a choice. They were to either work with Washington to squeeze Tehran to stop its nuclear programs and end its alleged terrorism, or continue to trade with Iran. Not a single European government was willing to cut economic links with Iran to side with the United States.\textsuperscript{1036} More recently, unlike in the case of Iraq, the European leaders have commonly stated that they would oppose military action against Iran.\textsuperscript{1037} On 17 June 2002, the E.U. gave the green light to launch formal trade relations with Iran, despite heavy pressure from the U.S. Hence, today, the E.U. is Iran’s main trade partner. In 2000, the E.U. imports from Iran totalled over $8 billion, more than 80 percent of which consisted of oil products, and exports to Iran amounted to $5.5 billion.\textsuperscript{1038} Although the E.U. does not provide Iran with weapons or nuclear technology, its energy investment and diplomatic support are valuable assets for Tehran. Another factor contributing to difficulties the U.S. is facing in getting the E.U. to stand by its side regarding Iran is the fact that Iran began pricing its oil in euros, and as of late 2006, 57 percent of Iran’s oil exports income was received in euros.\textsuperscript{1039} If this trend continues, the euro could establish a foothold in the international oil trade, which would be beneficial to the EU. It would also be beneficial to Iran as it would be logical that Iran is paid in the national currency of one of its major customers.\textsuperscript{1040}

\textsuperscript{1033} Ibid.
\textsuperscript{1034} Ibid.
\textsuperscript{1035} For more see Bruno Tertrais, “A Fragile Consensus,” \textit{The National Interest}, no. 83, Spring 2006, pp. 31-4.
\textsuperscript{1036} Wright, “Dateline Tehran,” p. 171.
\textsuperscript{1037} “Study on Energy Supply Security and Geopolitics”, p. 168.
\textsuperscript{1038} Ibid.
\textsuperscript{1039} Carl Mortishead, “Iran Turns from Dollar to Euro in Oil Sales,” \textit{Times} (London), December 22, 2006. This occurred even before the new Iranian Oil Bourse (IOB) was launched. For more on IOB, see “New Year Ambition for Iran’s Oil Bourse,” \textit{Middle East Economic Digest}, vol. 50, no. 11, March 17, 2006, p. 11; and Clark, \textit{Petrodollar Warfare}, pp. 150-60.
\textsuperscript{1040} The U.S. dollar has been the strongest currency of the world for more than half a century, with about 70 percent of all currency reserves in American dollars. This is closely related to the fact that oil, the most important commodity traded in the world, is mostly priced in U.S. dollars, and hence the majority of oil importing countries have to buy their oil in U.S. dollars, which in turn forces them to keep most of their foreign currency in dollars.
The E.U. often acts as a negotiator and thus helps the U.S. in pressuring Iran to abandon its nuclear program, and for most Europeans, Iran’s nuclear ambitions became a major preoccupation since August 2002 when an Iranian opposition group publicly disclosed the locations of two previously secret nuclear facilities in Iran. Nevertheless, the E.U. can do very little to punish Iran. If it attempts to impose sanctions against Iran, this would hurt the E.U. economy just as much as Iran’s, as a large share of Europe’s oil and gas comes from Iran (see Table 6.3). Thus, Iran sees its growing commercial ties with Europe as a source of advantage over Europeans. This is rightly so, as Europe would find it hard to replace oil and gas it imports from Iran with that from other sources, especially considering recent developments concerning oil and gas imports from Russia, and at times when oil supplies are extremely tight and there is limited spare production capacity.

<table>
<thead>
<tr>
<th></th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Italy</td>
<td>206.5</td>
<td>189.0</td>
<td>202.2</td>
<td>226.5</td>
<td>293.8</td>
</tr>
<tr>
<td>France</td>
<td>72.9</td>
<td>76.3</td>
<td>111.4</td>
<td>124.8</td>
<td>210.7</td>
</tr>
<tr>
<td>Others</td>
<td>568.9</td>
<td>445.3</td>
<td>520.1</td>
<td>567.5</td>
<td>556.7</td>
</tr>
<tr>
<td>Total Europe</td>
<td>848.3</td>
<td>710.6</td>
<td>833.7</td>
<td>918.8</td>
<td>1,061.2</td>
</tr>
</tbody>
</table>


Very few of European IOCs have felt bound by unilaterally imposed U.S. sanctions against Iran (ILSA). In September 1997, when the French company TotalFinaElf and the Russian giant Gazprom struck a $2 billion deal with Iran to develop the huge offshore South Pars field in the Persian Gulf, Washington issued thinly veiled threats to fine the company’s branches in the United States, but Total’s CEO Thierry Desmarest remained unimpressed. “Nobody recognises the extraterritorial character of the law, which goes against the principle of sovereignty in relations between nations. We reckon we are free in our movements,” he concluded. Lionel Jospin, the French Prime Minister, who noted, “no one accepts that the United States can now impose their laws on the rest of the world”, seconded Desmarest. The Clinton administration acquiesced, assuring that Total would not face legal consequences in this case. European companies have taken advantage of the absence of American competition on the Iranian oil market. A French diplomat suggested, “We [France] continue not to accept the sanctions of the United States. We generally reject the American logic that Iran must be isolated.” France, along with other European countries, seeks instead to integrate Tehran economically, and hence, just in 2001, trade between France and Iran grew by 50 percent. Although it is important to note that most European IOCs have recently put their potential projects in Iran on hold because

Thus, Iran’s move is a part of very intelligent, creative strategy to go on the offence in every way possible and mobilise other actors against the U.S., as oil in euros would benefit the E.U. and it would loosen the grip the U.S. has on OPEC members. If Iran launches the IOB, the U.S. dollar could weaken and the euro could strengthen, thus making imported goods more expensive for the U.S. and threatening its economic growth.

1041 In addition, in 2004, German companies exported goods worth $4.43 to Iran, and Germany was the largest exporter of goods to Iran. See “Key Nations’ Stances on Iran.” If sanctions were implemented against Iran, German exporters would suffer due to a loss of an important market.
1043 Both quoted in Aminneh Parvizi Mehdi, Towards the Control of Oil Resources in the Caspian Region (New York, 1999), p. 113.
1045 Ibid.
of the political uncertainties and pressure from the United States.\textsuperscript{1047} In summary, European policy towards Iran has diverged from Washington's, and this transatlantic divide has been playing into Iranian hands.\textsuperscript{1048}

With the exception of Japanese withdrawal from the Azadegan project, the evidence presented above suggests that rather than Iran, the U.S. has been isolated in its policy towards Iran. Tehran has been largely successful in balancing the pressure, which it receives from Washington by pursuing skilful diplomacy to gather support mainly from Beijing and Moscow, and to a lesser extent from New Delhi and various European capitals. Thus, the U.S. attempt at isolating Tehran diplomatically has been too tame.

\textit{Outcome}

As of early 2007, there is no end in sight for the Iranian nuclear saga, since Iran is neither close to acquiring nuclear weapons capability nor close to giving up its pursuit. Iran has long used oil as a tool for statecraft,\textsuperscript{1049} and in recent years, Iran has successfully used its oil connections with China and Europe, and various other connections with Russia, to pursue its nuclear program. Oil prices increase every time there is talk of sanctions or military action taken against Iran, due to the speculation associated with potential Iranian retaliation to sanctions or military action, which would involve oil. This shows how important Iranian oil is to the international oil market and it gives Iran a crucial bargaining chip in its pursuit of nuclear technology. Iranian leaders are pursuing nuclear technology in order to maintain regime stability from outside threats, particularly the U.S. and Israel. While they use oil to support their nuclear pursuit, oil also plays a crucial role in maintaining regime stability from inside threats, as oil export revenues are the lifeline of the economy. In order to maintain or increase its oil exports revenues, Iran needs to maintain or increase its oil export volumes,\textsuperscript{1050} and in order to do so its oil industry needs investment. While some of this investment is generated locally, the rest comes from abroad, as companies from China, Russia, France, and many more countries, continue investing in Iran's oil exploration and production, despite the U.S. sanctions. Considering the surging demand for oil imports in China and India, and the lack of opportunities for oil companies in many other countries, it is highly likely that these funds will keep on coming. Currently, Iran, China, Russia, and European oil companies are clearly on the winning side of the bargain, and the U.S., its oil companies, Japan, and Israel are on the losing side. For others, the E.U.-3 and India, who are stuck between a rock (the U.S.) and a hard place (Iran) it is rather unclear.

\textit{Analyses and Conclusions}

In the post-Iraq war environment the Tehran regime feels insecure, especially since the Pentagon now uses offensive doctrine of pre-emption as an add-on to its measures against non-deterrable threats ("axis of evil" states), as evident in the case of Iraq.\textsuperscript{1051} Iranian knowledge that Israel, a country that does not have diplomatic relations with Iran, has nuclear weapons creates a deep environment of insecurity in Iran. Thus, nuclear weapons would give Iran the implicit threat of retaliation against any international or regional actor that may choose to threaten its sovereignty. Iran's policy-makers have calculated that they can move forward with the country's nuclear program without any serious repercussions. Instead of worrying about what the U.S. might do to

\textsuperscript{1047} Leverett and Noel, "The New Axis of Oil," p. 69.
\textsuperscript{1048} For more on transatlantic divide over Iran, see Howard, \textit{Iran Oil}, pp. 45-71.
\textsuperscript{1049} For more, see Brumberg and Ahram, "The National Iranian Oil Company in Iranian Politics," p. 31.
\textsuperscript{1050} This implies that Iran needs to increase its production, since its domestic consumption has been rising steadily, and is thus eating into the oil available for exports.
\textsuperscript{1051} For more detail, see Record, "The Bush Doctrine."
hold back their nuclear program, Iranians have skillfully gathered support from Russia, and most importantly, China. The Sino-Iranian alliance is mutually beneficial: Iran supplies the energy-hungry China with oil, which is essential to China’s rapidly expanding economy (see Table 6.4). While in 2004 and 2005, around 11 percent of Chinese crude oil imports came from Iran, thus making it the third largest source of crude oil for China (Table 6.4), this figure increased considerably by early 2007, when with 515,000 bpd, or 15.6 percent, Iran became the largest source of China’s crude oil imports.\footnote{David Harman, “China’s Crude Oil Import Rises 3.5% in January,” Resource Investor, March 1, 2007.} Japan and India are in the similar situation as China regarding their oil imports from Iran (Table 6.4), and thus both countries have much to lose for not supporting Iran internationally. In return for access to its crude oil, China provides Iran with military and civilian nuclear technology, weapons and most importantly, diplomatic support. Sino-Iranian dealings are fuelled and politicised by both countries’ dislike of the United States.

Table 6.4: Iran’s Oil Exports to Asia (2004 and 2005; kbpd)

<table>
<thead>
<tr>
<th></th>
<th>2004</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Japan</td>
<td>630</td>
<td>581</td>
</tr>
<tr>
<td>China</td>
<td>266</td>
<td>287</td>
</tr>
<tr>
<td>India</td>
<td>220</td>
<td>205</td>
</tr>
<tr>
<td>South Korea</td>
<td>178</td>
<td>194</td>
</tr>
<tr>
<td>Asian “Big Four”</td>
<td>1,294</td>
<td>1,265</td>
</tr>
<tr>
<td><strong>Total Oil Exports</strong></td>
<td><strong>2,506</strong></td>
<td><strong>2,390</strong></td>
</tr>
</tbody>
</table>


In past, Iran threatened to review its oil contracts with countries voting in favour of sanctions before the U.N. Security Council. Its threat will hold much weight with China, especially as in the past Iran cancelled an energy project with India worth $22 billion, because India voted in favour of IAEA draft resolution threatening to bring the Iranian nuclear issue before the Security Council.\footnote{Xiao Jue, “Iran Retaliates Those Who Cast Yes,” Global Times, September 30, 2005 (author’s translation). The United States, Australia, Britain, France, Germany, Canada, Argentina, Belgium, Ghana, Ecuador, Hungary, Italy, the Netherlands, Poland, Portugal, Sweden, Slovakia, Japan, Peru, Singapore, South Korea, and India voted for the resolutions; Pakistan, Algeria, Yemen, Brazil, China, Mexico, Nigeria, Russia, South Africa, Sri Lanka, Tunisia, and Vietnam abstained, and Venezuela voted against the resolution. “International Consensus Against Iran Fails,” Tehran Times, September 25, 2005.} If China, the state which has so far been most adamant about keeping any international chastising of Iran, ever voted in favour of comprehensive sanctions, it would risk losing badly needed oil supplies from Iran. In other words, voting against the Iranian interests would have negative consequences for China because Iran is China’s major oil supplier, and its supplies could be reduced or cut. If China continues its international support of Iran it will likely be rewarded by winning over the contract to develop the world’s second largest oil field, Iran’s Azadegan, recently given up by Japan after U.S. pressure.\footnote{Iran’s Islamic Republic News Agency report quoted in Bremmer, “Playing the Oil Card.”} If the nuclear controversy leads to Iran’s total isolation from European and Japanese oil companies, then Tehran will increasingly turn to Chinese NOCs, supplement their investment capital with expertise from more technologically advanced Russian companies, and rely on government-to-government marketing deals.

Iran’s nuclear ambiguity is calculated, a reaction to the vulnerability it feels. The imminent security threat from the U.S. and Israel might cause Iran to back down, but it could also have the
opposite effect, encouraging Iran, just like North Korea, to leave the NPT,\footnote{Iran could abandon the NPT if forced to limit nuclear activities, Mahmoud Ahmadinejad, its hardline president says. “Iran ‘Could Quit Nuclear Treaty’,” BBC News, February 11, 2006, \url{http://news.bbc.co.uk/2/hi/middle_east/4703434.stm}, [February 15, 2006].} and to develop a nuclear weapon as fast as possible. After all, a country that sees the U.S. as a potential threat to its security would likely place substantial value on nuclear weapons, because they are the only means of offsetting U.S. conventional superiority.\footnote{Glaser and Fetter, “Counterforce Revisited,” p. 112. For analyses of states’ nuclear acquisition decisions, see Scott D. Sagan, “Why Do States Build Nuclear Weapons? Three Models in Search of a Bomb,” \textit{International Security}, vol. 21, no. 3 (Winter 1996/97), pp. 54-86; and T.V. Paul, \textit{Power versus Prudence: Why Nations Forgo Nuclear Weapons} (Montreal: McGill-Queen’s University Press, 2000).} However, Iran is likely to neither back down nor become a nuclear weapon state in a short period of time. Iran’s drive for nuclear weapons has thus far been checked by a combination of potential obstacles created by Russia, the United States, Europe, and the IAEA, but it has not been entirely blocked, and more obstacles will emerge in future. In past, Russia has slowed completion of the nuclear reactor at Bushehr, and managed to persuade Iran to agree to return the used fuel. The United States has applied unilateral sanctions, attempted to isolate Iran, and hinted at forceful regime change. Europe has partially restrained investment and warned of future sanctions. Finally, the IAEA has insisted on full disclosure of Iran’s nuclear programs and inspections on demand, alleged Iran of violating its NPT obligations and referred the case to the U.N. Security Council for enforcement. However, getting to the Council is one thing; getting action from it is another. In this multidimensional chess game, Iran has moved strategically and pragmatically in response to each of its opponents, seizing openings to move its nuclear program ahead wherever and whenever they arise.\footnote{Graham Allison, \textit{Nuclear Terrorism: The Ultimate Preventable Catastrophe} (New York: Times Books, 2004), pp. 162-3.} 

Military options against Iran are not logistically feasible or politically prudent in the context of high oil prices, and are currently not credible and illegal. Therefore, for these reasons, Iranian regime appears secure from any outside threats. Some have argued that complete or substantial economic isolation, including severing trade relations and prohibition for Western companies to conduct business with Iran, as the U.S. has already tried in the oil industry, would almost bring the country to a halt.\footnote{Matthew Karnitschnig, “European Firms React to U.S. Hard Line on Iran,” \textit{Wall Street Journal}, January 28, 2005.} The problem with this approach is that sanctions are generally ineffective, and they would almost certainly be ineffective in the Iranian case.\footnote{Vakil, “Iran: Balancing East against West,” p. 61; Cordesman and Al-Rodhan, “Iranian Nuclear Weapons?”} Further, Russia and China would vote against the imposition of any comprehensive sanctions. Finally, the American attempt at isolating Tehran has backfired, and instead, the U.S. government has been isolated in its Iran policy. High oil prices have greatly enhanced national revenue from oil exports and have allowed the Iranian government to keep popular disaffection manageable.\footnote{Vakil, “Changing Iran’s Nuclear Interests,” p. 5.} At the moment, hopes for a regime change within Iran do not seem realistic, and internal stability is ensured as long as revenues from oil exports are maintained at their current, high levels. The bottom-line is that Iran uses both its oil wealth and its attempt to acquire nuclear weapons in order to maintain and ensure the regime stability, which is threatened from domestic and international actors. During its nuclear pursuit, “it is the high price of oil that most bolsters a sense of immunity in Tehran,” and “while energy prices remain high, Iran’s leaders believe, and all Iranians hope, that the world will not dare boycott Iranian oil.”\footnote{―Whistling in the Gloom.”}

Issue linkage is very influential in the process of Iranian nuclear bargaining, and may be crucial in determining the outcome. Main factors influencing nuclear bargaining come from Iranian domestic bargaining arena, Iranian oil industry bargaining, China’s domestic bargaining arena,
and are influenced by high oil prices. Iran’s regime stability crucially influences nuclear bargaining. In order to ensure their regime’s stability, Iranian leaders use the ‘oil weapon’ to gain support in the international arena in order to block sanctions, continue their nuclear pursuit, and balance the U.S. attempt to isolate Iran and force regime change. Hence, Iran offers oil for support at the U.N. Security Council and for other international support, which it primarily receives from China. Thus, Iranian oil industry bargaining is the crucial reason why Iran receives Chinese support, and hence it has an important, albeit indirect impact on nuclear bargaining. Due to their desperate need for more oil in order to fuel their growing economy, the Chinese are more than willing to invest in Iran’s oil industry, despite American pressure against this. Chinese and other countries’ investment in Iran’s oil industry help Iran maintain its oil export revenues, which are essential to keep domestic discontent manageable. Finally, besides foreign investment, current high oil prices also help Iran in receiving large oil export revenues, essential for domestic political stability. High prices also make oil exploration and production very profitable, thus providing oil companies with a higher incentive to invest in Iranian oil.

Besides the Iranian government, which is successfully attracting investment in the Iranian oil industry, and is receiving necessary revenues from oil exports, Chinese, Russian, Brazilian, Malaysian, Indian and other developing countries’ NOCs and European IOCs are currently the main beneficiaries from Iranian oil industry bargaining. Since the American IOCs are prohibited from investing in Iran, and the Japanese companies are now only minority players, the others have less competition. The European companies may soon find themselves on the losing end of the bargain as their governments have recently succumbed to the U.S. pressure, and some of them have indicated that they may exit Iran if any comprehensive sanctions against the Islamic Republic are implemented. Thus, the future looks promising for many NOCs willing to maintain and increase their investments in Iran, and therefore also for the Iranian government, which, if there is high interest for investment in Iran, will be able to maintain current favourable terms of investment and its control over the oil industry.

**Relationship with Hypotheses**

The case study of Iran’s contemporary oil industry bargaining has direct relevance to all of the hypotheses set in Chapter 2. Evidence presented in this case study is supportive of hypothesis one. Due to their weak bargaining power, the IOCs have been on the losing side of their bargain with Iran in the current decade, and were not able to improve their investment terms vis-à-vis the Iranian government. Evidence is not supportive of hypothesis three. Since the interests of American IOCs and the U.S. Government are not aligned concerning Iran, then the U.S. Government does not support the American IOCs in oil industry bargaining in Iran, and thus, the American IOCs are not successful in their bargaining. In addition, evidence presented is supportive of hypothesis three, since the IOCs are losing bargaining power in general, and in Iran in particular, due to the rise and interference of the NOCs from oil importing countries, such as China. Additionally, evidence is mixed with regards to hypothesis four, since although both China’s and Japan’s oil supply security is perceived as threatened when bargaining in Iran, with concerns related to the oil supply security dominating China’s oil industry bargaining in Iran, only China emerges victorious. Finally, empirical evidence is not supportive of hypothesis five, as Iran uses oil, explicitly and/or tacitly, in its bargaining with other actors, and this allows it to gain concessions from these actors, particularly in its pursuit of nuclear technology. These primary conclusions will be elaborated on in the following chapter when I discuss my findings in more detail.
PART 3: CONCLUSIONS

After engaging in six case studies examining oil industry bargaining scenarios in four previous chapters, in Part 3 of this dissertation, I discuss the findings, elaborate how and why they provide significant contributions to literature, and based on the findings, propose policy implications for various actors in the oil industry. Finally, I outline various points that deserve further scrutiny, and thus suggest paths that further research should follow. This part is divided in two chapters. In Chapter 7, I discuss the findings by revisiting the hypotheses set in Chapter 2, and by elaborating on additional conclusions. In Chapter 8, I outline this study’s original contributions to knowledge, offer policy implications for various actors in the oil industry, and finally suggest issues that warrant further research.
DISCUSSION OF FINDINGS

In chapters 3 to 6, I analysed six cases of contemporary bargaining in oil industries of four different countries – Russia, Venezuela, the United States, and Iran. In doing so, I highlighted the importance of political factors, but also economic factors, in determining bargaining outcomes, and this supports my decision to characterise the oil market as politicised. Moreover, I emphasised the importance of nesting, or issue linkage, between oil industry bargaining and domestic, international, and/or strategic security bargaining in all six cases. In Chapter 3, I looked at two cases of contemporary bargaining in Russia – firstly, domestic oil industry bargaining between Putin, the oligarchs, and IOCs involved in the country, and secondly, oil pipeline bargaining between Russia, China and Japan. In the first case, I argued that Putin’s consolidation of Russia’s oil industry, by limiting the power of the oligarchs and changing investment legislation against the wishes of IOCs present in Russia, are measures aimed at increasing government’s domestic and international power. Russia has lost much of its image of a great power after the end of the Cold War, and the break up of Soviet Union. Consolidation and control of the oil industry may assist Putin in returning Russia some lost power. The oligarchs and IOCs are on the losing end of this particular bargain, as they are unable to stop Putin in his intentions.

In the second case of contemporary oil industry bargaining in Russia, in which I studied pipeline bargaining between Russia, Japan and China, I found that China is more likely to be prioritised in the construction of Russian Far Eastern pipeline. This is so because of Russia’s attempt to maintain friendly relations with Beijing, what stems from its perceived strategic security threat from China. Further, reasons also come from China’s strategic security concerns, as China attempts to achieve oil import diversification, mainly away from dependence on the Middle East and American power, in order to satisfy its increasing thirst for imported oil. Additionally, Chinese domestic factors influence this particular bargaining case, as it is crucial for China to ensure sufficient energy supplies in order to maintain rapid economic growth, which in turn, is the basic foundation of domestic regime stability. It is important to note that the unsolved issue of Kuril Islands, Japanese decreasing oil demand, and uncertainty about Russia’s ability to produce sufficient amount of oil for the ‘Japan’ route, also point to China being prioritised in future.

In Chapter 4, I studied contemporary oil industry bargaining in Venezuela, arguing that Venezuela’s domestic factors carry the most influence on the outcome of this bargaining case. It is crucial for Venezuelan President Hugo Chávez to ensure sufficient oil revenues in order to “buy” the political stability at home. Thus, his control of the oil industry is simply a tool utilised to achieve this fundamental objective. The entry of NOCs plays an important role in Venezuela’s oil industry bargaining, as they offer Chávez a crucial alternative to IOC investment. Therefore, IOCs’ bargaining power is diminished and they have no option but to acquiesce with increased taxes and royalties, or they will be forced out of Venezuela. Unlike in Russia, which is not a typical petro-state, as it depends on natural gas export revenues just as much as on oil export
revenues, high oil prices help Chávez to achieve regime stability and succeed in his bargaining with the United States and IOCs. Among many other countries, China and its NOCs provide Venezuela with an alternative to IOCs for investment in its oil industry. China, and many other developing countries, benefit from Venezuela’s political antagonism with the United States, by being able to invest in Venezuela’s oil industry, and import Venezuelan oil. As in Russia, IOCs are also on the loosing end of the bargain in Venezuela.

In Chapter 5, I studied two contemporary oil industry bargaining cases in the United States – firstly, bargaining for UNOCAL, a mid-sized American independent oil company, and secondly, bargaining for the rights to drill and explore for oil in Alaska’s ANWR. In the first case, I found that the U.S. domestic and strategic security factors carried the highest influence on the bargaining outcome. Domestic lobbying by Chevron, which eventually acquired UNOCAL, and government’s opposition to a Chinese purchase of an American oil company, were important factors in influencing CNOOC to pull out. Further, U.S. government’s commitment to prevent hegemonic challenger (China) from acquiring strategically important assets (oil) was also highly relevant factor in influencing the bargaining outcome. It is important to mention that in this particular case, IOCs (Chevron) benefited, and NOCs (CNOOC) were on the losing end of the bargain.

In the second case of contemporary oil industry bargaining in the United States, I argued that the Bush administration’s false energy security perception that America can be less dependent on imported oil and can achieve oil independence, which stems from America’s strategic security concerns, is the driver behind Bush administration’s pursuit of drilling rights in Alaska’s ANWR. The fact that the Bush administration, backed up by the oil lobby and Alaskan government, has been unsuccessful in past and continues to be unsuccessful in present, is the result of strong domestic opposition from environmentalist circles, which successfully lobby Democrat congressional representatives. The environmentalist success would have been very limited and the ANWR would have most likely been open for drilling in the near future had the Democrats not won the November 2006 mid-term elections, which put them in control of both Congress and the Senate. If the ANWR were opened for drilling and exploration, IOCs would have been strengthened by acquiring additional oil reserves and would therefore increase their production. However, after November 2006, this is highly unlikely, and IOCs, the Bush administration and the State of Alaska are, for the time being, on the losing end of the bargain.

In Chapter 6, in which I studied contemporary oil industry bargaining in Iran, I found that main issue linkage factors influencing Iranian oil industry bargaining come from Iranian domestic and strategic security factors, and from China’s international posture. Iran’s regime stability, from outside and inside threats, crucially influences oil industry bargaining. Iran seeks to find supporters in the international arena in order to balance the U.S. attempt to isolate it, and force regime change. Hence, Iran offers oil for international support, which it primarily receives from China. Iran also receives support from Russia, to which it is a lucrative weapons and nuclear technology market, and to a lesser extent from the E.U. and India, countries that import substantial amounts of oil from Iran. It is important to note that China and most likely Russia would veto any comprehensive U.N. Security Council sanctions against Iran. Foreign investment in the Iranian oil industry, although not from any American IOCs as they are barred by their government, helps Iranian leaders to maintain/increase Iran’s oil production and oil export volumes, revenues from which enable them to sustain political stability. Besides the Iranian leaders, NOCs and European oil companies are on the winning end of oil industry bargaining in Iran, something that cannot be said for their American counterparts.
In this chapter, I critically discuss the above findings by revisiting the hypotheses set in Chapter 2. The hypotheses are revisited and discussed in this chapter, as it is more systematic to discuss their validity here than in chapters 3 to 6 while engaged in the case studies. The discussion of findings serves as the basis for analysing their implications in Chapter 8.

Hypotheses Revisited

Hypothesis 1:

If due to their weak relative bargaining power, IOCs have been on the losing side in their bargaining with oil exporting countries and/or their NOCs in the current decade when compared to the late 1990s, then we are witnessing the return of the obsolescing bargain.

In order to test this hypothesis, I use two frameworks – exit, voice, and loyalty, inspired by Albert Hirschman, and set in Chapter 2; and my own IOCs-host state bargaining power model, established in Chapter 2 and Appendix 1. Both frameworks are useful in establishing IOCs’ relative bargaining power vis-à-vis host states. While exit, voice, and loyalty framework determines the IOCs’ power based on their actions in Venezuela, Iran, and Russia, the second framework utilises 19 variables in order to compare relative bargaining power between the IOCs and Venezuela, Iran, and Russia, in 1998/99 and 2005/06.

Since bargaining power is “the major determinant of [government] intervention,”1062 bargaining outcome directly depends on the relative bargaining capabilities of the host country and the multinational.1063 In other words, the actual distribution of benefits, or the outcome of a given bargaining situation, “depends on the terms of the agreement which are, in turn, a function of the relative bargaining power of the host country and multinational corporation.”1064 In the oil industry, a host government’s intervention policy imposes severe constraints on an IOC’s strategy and operations within the host country, and its relative bargaining power vis-à-vis the IOCs is the major determinant of government intervention.1065 Hence, overall, bargaining outcome is a direct function of relative bargaining power between IOCs and host states. IOCs’ bargaining power is indicated by the nature and size of bargaining outcomes they achieve through interactions with host governments.

As evident from studying bargaining in both Venezuela and Russia’s oil industries, most IOCs present in these two countries did not opt to voice their concerns when Russia and Venezuela altered their investment legislation. Indeed, due to their low voice and exit potential, many wished to remain loyal (Royal Dutch/Shell, Chevron, BP and Repsol in Venezuela for example), and did not voice their concerns despite the fact that terms of their contracts were becoming increasingly unfavourable (see Figure 7.1). There were two cases in Venezuela in which IOCs voiced their concerns. Italy’s ENI and French Total failed to acquiesce to Venezuelan government’s new terms, and were afterwards forced to handover their operations to PdVSA, and thus to exit. ENI and Total’s low exit and voice potential resulted in unfavourable bargaining outcome for these two companies. Exxon Mobil sold its small stake in one of the fields to Spain’s Repsol in order to avoid direct confrontation and obvious defeat in Venezuela.

1062 Poynter, Multinational Enterprises & Government Intervention, p. 39.
1065 For more detail, see Poynter, Multinational Enterprises & Government Intervention.
Exxon Mobil was therefore, the only company that opted to exit, but it is important to note that the size of the field at stake was small (16,000 bpd) and that Exxon Mobil acquiesced to government’s demands concerning a much larger field in the Orinoco Tar Belt. This shows that even the ‘mighty’ Exxon Mobil avoided confrontation with Venezuela.

In Russia, when terms of Sakhalin-3 project were changed, Exxon Mobil and Chevron did not voice their concerns, what illustrated their low voice and exit potential. The same applied for BP, which demonstrated loyalty after being presented with a large and arbitrary tax bill, for Royal Dutch/Shell, when in December 2006 Russia suspended its vital permit for Sakhalin-2 venture, and for all IOCs present in Russia when in February 2005, Russian government decided to ban majority foreign participation in new natural resource concessions. Overall, IOCs in both Venezuela and Russia have fallen in line with the government, with almost no protest each time investment regulations were altered. This says much about the balance of power between governments and their NOCs, and international investors. In Iran, ‘buyback’ contracts have been a mainstay in the oil industry since they came into practice in 1995, despite unfavourable terms for IOCs, and when they were introduced in the mid-1990s, they reflected Iran’s need for additional foreign investment. Buybacks are arrangements in which the contractor funds all investments, receives remuneration from NIOC in the form of an allocated production share, then transfers operation of the field to NIOC after the contract is completed. Under ‘buyback’ contracts, companies have no guarantee that they will be permitted to develop their discoveries, let alone operate them, and many companies do not like their short terms. Although the IOCs present in the country find ‘buyback’ agreements extremely unfavourable, they did not opt to voice their concerns or exit. While the persistence of buybacks points to inevitably weak IOC bargaining power vis-à-vis the Iranian government and NIOC, the buyback system is reflective of many other Middle Eastern countries, whose oil industries remain closed to private investment. Comparably, Iran is attractive to IOCs in contrast to Saudi Arabia, as its upstream oil sector is at least theoretically open to foreigners under the 1987 law. All this shows that IOCs in Iran (Royal Dutch/Shell, Total, and ENI) have low voice and exit potential (see Figure 7.1).

Figure 7.1: IOCs’ Exit and Voice Potential Matrix in Iran, Russia, and Venezuela

![Figure 7.1: IOCs’ Exit and Voice Potential Matrix in Iran, Russia, and Venezuela](image)

Generally, the view held by many of today’s globalisation scholars is that some form of fundamental technological shift is taking place that enhances the power of MNCs against the
state. It is particularly apparent in the argument that technological change has increased the power of mobile capital (MNCs) vis-à-vis immobile actors (states) in general. The core of this argument is that enhanced mobility constitutes a form of ‘exit’ power for capital agents, providing them with a form of bargaining power. In the present context, it is commonly claimed that mobile MNCs can ‘arbitrage’ different political and economic jurisdictions, producing a ‘race to the bottom’ in terms of regulatory policy and the costs of doing business. Although this implicit threat of exit by itself may tend to bias economic policy in favour of business preferences, it is also sometimes held to increase the political ‘voice’ of international business. In this view, we ought to see an increase over time in the influence of business over policy. However, I found that exit and voice potential of MNCs in the oil industry is low in this decade, as IOCs have lost their influence over the host states.

The second framework utilized to assess bargaining power of the IOCs relative to host states (oil exporting countries) was set up in Chapter 2 (see Figure 2.3), and Appendix 1. From a review of the relevant literature, numerous host country/industry context variables and IOC-specific variables have been identified. As illustrated in Figure 2.3 and elaborated in Appendix 1, IOCs’ bargaining power in a particular host state is determined by industry and country context, by taking into account: the level of competition in the country of interest; local technological and managerial know-how; capital possession; strategic importance of industry for the host country; cultural/political context; barriers to entry; reserve size and longevity; the level of economic development; potential profitability of IOC’s operations in this country; political and economic risk ratings; market access of that particular country’s NOCs; perception of world oil abundance/scarcity; and world oil market prices. It is also determined by analysing IOCs’ resources: technological know-how; capital possession; management skills; reputation; reserve replacement; availability of local allies; access to markets; and availability of alternative investment options. In Appendix 1, I elaborate on each of these variables and offer supportive scholarly evidence, which underlines their selection, and also briefly outline reasons for not including some other variables. In Appendix 8, I explain methodology behind variable measurement and assign values to each particular variable. Based on empirical data from previous chapters, in order to assess relative bargaining power of IOCs vis-à-vis host countries, values (between 0 and 5) have been awarded for each of the industry and country context variables in Russia, Venezuela and Iran; IOC specific variables; and relative variables for each of these countries for both 1998/99 and 2005/06. In Appendix 8, I also discuss the reasons for awarding a certain value to each of the variables. With regards to the values, while “0.00” indicates that IOCs possess highest possible bargaining power relative to the host state, “5.00” signifies that the host state has highest possible bargaining power vis-à-vis the IOCs, and “2.50” indicates bargaining power equilibrium (for more on methodology and value measurement, please refer to Appendix 8). The main findings are presented in Figure 7.2.

Figure 7.2: Relative Bargaining Power between Iran, Venezuela and Russia, and IOCs (1998/99 and 2005/06)

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As evident from Figure 7.2, Iran, Venezuela, and Russia improved their bargaining power vis-à-vis IOCs between 1998/99 and 2005/06. While Russia and Venezuela possessed low (Russia 1.89, Venezuela 2.00) and Iran medium (2.54) bargaining power against the IOCs in 1998/99, all three countries possessed high (Iran 3.59, Russia 3.45 and Venezuela 3.46) bargaining power vis-à-vis IOCs in 2005/06. While bargaining power improvements vis-à-vis IOCs between 1998/99 and 2005/06 are more prominent for Venezuela (+1.46) and Russia (+1.56), they are less prominent for Iran (+1.05). This stems from the fact that Iran already in 1998/99 possessed relatively high bargaining power vis-à-vis IOCs, and thus their change is not as pronounced as in Venezuela and Russia (see Figure 7.2).

Due to this bargaining power improvement, in the current decade, host governments can dictate the size of their cut in bargaining with IOCs. As evident from the case studies, they have adjusted their tax regimes, existing contracts and entry terms. Iran, Russia and Venezuela are wary of allowing the major IOCs in at all, and the doors are certainly closing to any major new IOC investment in any of these countries. In addition, besides tax and royalty hikes, we are witnessing increased state participation in oil projects in Russia and Venezuela, and continuation of high state participation in Iran.

Latin American and Middle Eastern governments, such as Venezuela and Iran, are ‘old hosts’ to FDI, and therefore have much experience with multinationals. La apertura in Venezuela’s oil industry, which was just a segment in rapid privatisation of key politically sensitive sectors in Latin America in the 1990s, caused a backlash from governments and general public as the number of foreign takeovers reached significant levels. The openness to FDI in Latin America in the 1990s generated enough resentment, which was required to swing the pendulum in the other direction. Whereas MNCs in general were offered subsidies and tax cuts to invest in Latin American economies in the 1990s, and here note 1 percent royalties paid by IOCs producing in Venezuela’s Orinoco Tar Sands, these generous terms are now being eliminated, and governments are increasingly regulating their politically sensitive industries. In the current decade, Chávez has marginalised the private sector by changing Venezuela’s hydrocarbon legislation. The heavy-oil projects, which have so far remained under private control, are likely to fall under state control soon. Besides oil industry in Venezuela, increased regulation and/or
nationalisation followed in Bolivia and Ecuador, and it would not be surprising if it continues elsewhere. In May 2006, President Evo Morales’ sensational decision to nationalise Bolivia’s oil and gas assets sent the already volatile oil markets into a panic. Recently, Ecuador joined its Latin American neighbours when it seized an oil field controlled by Occidental, a United States-based IOC.

Iran never reopened its oil industry for substantial FDI in the 1990s. Buyback contracts, which were introduced in 1987, are short-term risk service contracts, which make foreign investor simply a contractor that never gains equity rights. In Iran, the bargain for some IOCs, mainly American, did not obsolesce as they were blocked by U.S. imposed sanctions, which blocked them from entering Iran in the first place. The bargain the European IOCs reached with Iran is obsolescing, and thus is similar to the situation in which the Japanese oil company Inpex found itself in. The European governments, similar to Japan, increasingly pressured by the Bush administration and increasingly intolerant of Iranian clandestine nuclear activities, are exerting tacit pressure against their own IOCs not to engage too heavily in the Iranian oil industry. The bottom line is that they are not needed. Iran can find substitutes, Chinese NOCs, which are more than willing to invest in Iran.

Russia, a transition economy, has like other transition economies, very little experience with inward FDI. In the 1990s, following the collapse of Communism, Russia’s economy was open for investment, which has been an important component of the economic reform program. Its initial openness, evident in pro-FDI policies and privatisation, was ‘the calm before the storm’, which started with Putin’s crackdown on Yukos in mid-2003. What followed was ‘re-nationalisation’ of much of Russia’s oil industry, increased regulation and higher taxes, or in other words, increasingly anti-FDI climate, as Russia retreated from liberalisation and returned to high levels of state control. By understanding how important it is for a developing, transition economy to control its oil industry as relying on global market forces alone did not serve Russia’s interests, it has quickly learnt how to deal with the presence of MNCs, and IOCs in particular. Putin understands that goals and interests of these MNCs mainly do not coincide with Russia’s, and thus the door is now closed for major IOC participation in its oil industry. Thus far, Putin has largely accomplished his goal of re-nationalising hydrocarbons resources, and as shown, legislation introduced in 2005 makes foreign investment in the country’s most geologically attractive areas much more difficult. Although not studied in detail in this dissertation, in January 2004 similar development has taken place in Kazakhstan, another former Soviet transition economy, which toughened its contract terms, limited foreign ownership in ventures, removed tax stability clauses and introduced a new escalator tax.

This resurgence in resource nationalism is not confined to Latin America, former Soviet Union or the Middle East. In Angola, Nigeria, Chad, Sudan and elsewhere, local protests for a greater share in the nation’s mineral wealth have disrupted production frequently. Nigeria and Angola have linked access to upstream assets to investments in other parts of the economy and continued to demand large signature bonuses. In virtually every oil-exporting country, NOCs, which had reluctantly ceded ground to IOCs in the wake of globalisation, seem to be reclaiming lost ground. Currently, IOCs are taking a beating from national governments in many parts of the globe.

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There is a seesaw of power balance between governments and firms, determined by the particular circumstances of the times. In Chapter 1, I examined the changing balance of power in past and current decades. In the current decade, when considering exclusively empirical evidence from the oil industry, the nation state appears robust as a regulator of IOCs. The world is witnessing a resurgence of resource nationalism. I found no evidence to demonstrate that in the first decade of the new millennium governments are fading away in the face of the power of IOCs. On the contrary, I found evidence that IOCs’ bargaining power is fading away vis-à-vis that of host states, and that IOCs possess low bargaining power vis-à-vis host states, and low exit and voice potential. At the same time, resource nationalism is back at the forefront of relations between host governments and IOCs. The IOCs’ bargain is obsolescing once again (see Figure 7.3).

Figure 7.3: Bargaining Outcome in Iran, Russia, and Venezuela as a Function of IOCs’ Relative Bargaining Power (1990s and 2000s)

What are some of the main drivers behind host states’ rising bargaining power vis-à-vis IOCs between 1998/99 and 2005/06? In other words, why has IOCs’ bargain re-obsolesced? In Table 7.1, I summarise the main factors, which contributed to higher bargaining power of host states as opposed to IOCs in 2005/06 as opposed to 1998/99. This table indicates the average difference in Iran, Russia, and Venezuela’s bargaining power vis-à-vis IOCs for both 1998/99 and 2005/06. There are six crucial reasons (with ‘high’ and ‘very high’ influence) which explain why IOCs’ bargaining power obsolesced. First, global perception that oil is becoming increasingly scarce and that world oil production may peak in the not too distant future, endows states that possess much of remaining oil with a lot of bargaining power vis-à-vis those who need this oil.\(^\text{1072}\) Oil spare production capacity is a good indicator of general abundance or scarcity of oil. While in 1998 global oil spare production capacity stood at 8 percent of total oil demand, by 2005 it dropped to only 2 percent of world oil demand.\(^\text{1073}\) Thus, it is not surprising that there are widespread perceptions of future oil scarcity and oil production peak, which in 2005 negatively affected IOCs’ bargaining power vis-à-vis Iran, Russia, and Venezuela.

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\(^\text{1072}\) Whether this perception is correct, something no one can answer is not of any importance.

Table 7.1: Influence of Various Variables on Host States’ Increase in Bargaining Power vis-à-vis IOCs between 1998/99 and 2005/06

<table>
<thead>
<tr>
<th>Influence</th>
<th>Variable</th>
</tr>
</thead>
<tbody>
<tr>
<td>Very High</td>
<td>Oil Scarcity Perception</td>
</tr>
<tr>
<td></td>
<td>The Lack of Alternative Options for IOCs</td>
</tr>
<tr>
<td>High</td>
<td>Host State’s Cultural/Political Context</td>
</tr>
<tr>
<td></td>
<td>Oil Prices</td>
</tr>
<tr>
<td></td>
<td>Competition in Host State</td>
</tr>
<tr>
<td></td>
<td>Low IOC Reserve Replacement</td>
</tr>
<tr>
<td>Medium</td>
<td>Host State’s Production Profitability</td>
</tr>
<tr>
<td></td>
<td>Host State’s Barriers to Entry</td>
</tr>
<tr>
<td></td>
<td>Host State’s Strategic Importance of Oil</td>
</tr>
<tr>
<td></td>
<td>Low IOC Reputation</td>
</tr>
<tr>
<td></td>
<td>Lack of Local Allies for IOCs</td>
</tr>
<tr>
<td></td>
<td>Relative Capital Possession</td>
</tr>
<tr>
<td>Low</td>
<td>Host State’s Reserve Size</td>
</tr>
<tr>
<td></td>
<td>Host State’s Reserve Longevity</td>
</tr>
<tr>
<td></td>
<td>Host State’s Economic Development</td>
</tr>
<tr>
<td></td>
<td>Relative Technological Know-how</td>
</tr>
<tr>
<td></td>
<td>Relative Managerial Skills</td>
</tr>
<tr>
<td></td>
<td>Relative Market Access</td>
</tr>
<tr>
<td>None</td>
<td>Host State’s Political/Economic Risk</td>
</tr>
</tbody>
</table>

Difference: none = 0.00; low = 0.01 – 0.99; medium = 1.00 – 1.99; high = 2.00 – 2.99; very high = 3.00 and over.

Second, nowadays, IOCs do not have alternative, equally or more, attractive options to pursue when bargaining with governments of Iran, Russia and Venezuela. Countries and ‘safe zones’ that are open to IOC investment are those in which oil production has already peaked and production is costly (lower U.S. states, North Slope of Alaska, the Gulf of Mexico, North Sea); where IOCs’ presence is already established (U.S., U.K., Canada, Australia); where new production is possible only if oil prices remain at very high levels (Alberta); in areas where there are huge technical challenges and production is expensive (Siberia, Alberta, offshore West Africa); or in alternative energy sources (oil shale, natural gas). Many of these options are very risky, as they may become unprofitable if oil prices drop in future. In addition, IOCs are not welcome in the major oil-producing region of the world, the Middle East, and also in North Africa, and much of Latin America. If they are present in some countries in these regions, it is usually, as in Iran, under unfavourable terms. Similar to what is taking place in Russia and Venezuela, IOCs are also struggling to maintain their presence in Kazakhstan, Ecuador, Bolivia, Chad and Nigeria. In addition, similar to Russia and Venezuela, Libya and the U.K. have made changes aimed at getting a bigger take of their oil resources. Analysts suggest that Angola, Africa’s fourth largest oil producer, will soon renegotiate some of its contracts with IOCs. Africa, former Soviet Union, the Middle East and Latin America, regions in which IOCs most want to do business, are becoming increasingly difficult operating environments. All these factors reduce IOCs’ bargaining power vis-à-vis Iran, Russia and Venezuela.

Third, the loss of IOCs’ bargaining power vis-à-vis host states is further exacerbated by the hostile political and cultural context in Iran, Russia, and Venezuela. While the 1990s in


Venezuela and Russia witnessed opening of these countries’ oil industries to foreign investment due to favourable political context, in this decade both countries have become increasingly hostile and opposed to the IOC involvement, due to the changed political context. As evident from chapters 3 and 4, both countries need government control of oil to further their goals in other bargaining arenas (such as domestic and international politics). Likewise, anti-British and anti-American sentiment in Iran and Iranian pursuit of nuclear technology is resulting in slow IOC removal from the country. American IOCs have not been present there since mid-1990s and European IOCs have recently been discouraged from investing there. Where strong nationalist feeling exists, as nowadays in Russia, Iran and Venezuela, it is “particularly likely to be directed at foreign oil companies,” since oil is a non-renewable resource and it carries a lot of strategic significance. Additionally, when dealings between the government and companies are widely publicised in the press and other media, as they are in Iran, Russia, and Venezuela, the government tends to have a bargaining advantage. Since IOCs are often portrayed as foreign interlopers, the government can utilise public opinion to sway negotiations toward more favourable outcomes. Therefore, due to these developments, bargaining power of Western IOCs vis-à-vis the host governments of Iran, Russia and Venezuela is weakened.

Fourth, when oil prices are low, and when IOCs have little cash available, as in the latter parts of the 1980s and for most of the 1990s, oil executives are courted by commodity-rich countries to develop their national resources. However, when prices rise, as they did in early years of the new millennium, host governments have a tendency to rethink their contracts and seek higher taxes and royalties. Leonardo Maugeri, a senior executive for strategy at ENI, argues, “It’s quite natural that during a period of high prices, the phenomenon of resource nationalism returns.” Such moves are “a by-product of high prices.” This state of affairs corresponds well to Ernest Wilson’s model of the politics of the world oil market – the petro-political cycle (PPC). The PPC model posits that the likelihood and the direction of market politicisation are a direct function of the boom-and-bust phase of that market; thus, petro-politics at the peak of the market will differ substantially from politics at the trough. In rising markets, sellers, such as oil exporting governments, gain leverage; in falling markets, buyers, such as IOCs or oil importing governments, gain leverage. In addition, in times of rising prices, developing governments, which occupy a subordinate position in the international system, have real incentive to alter the basic rules of the game and reverse this status quo. While their chances of doing so improve greatly in rising markets, they decline in falling ones.

Fifth, high level of competition in the oil industry is one of the main reasons behind the decrease in IOCs’ bargaining power vis-à-vis host governments. Various other actors, such as NOCs from both oil exporting and primarily from oil importing countries, service companies, and consultancy firms, compete with IOCs as they often offer same or similar services, and therefore provide host governments with more options. IOCs face higher level of competition in Iran, Russia and Venezuela in the current decade than they did in the 1990s, and this carries a negative effect on their bargaining power against governments of these countries. While competition in Iran might be lower than in Russia and Venezuela due to the absence of American IOCs and service companies, it is still high due to the presence of developing countries’ NOCs. Many of these countries, particularly China, maintain close relationship with the Iranian regime. Local

1077 See Grosse, Multinationals in Latin America, p. 83.
1078 Quoted in Mouawad, “Western Firms Feel a Pinch from Oil Nationalism.”
service companies also offer important services to the NIOC. \textsuperscript{1081} An NIOC manager explained their perspective:

Service companies can provide services often at a better cost than IOCs. This is also true with Iranian service companies. They can do exploration services, seismic, drilling, tankers…. There are many, many alternatives to IOCs.\textsuperscript{1082}

In Venezuela, there are a wide variety of IOCs, developing countries’ NOCs (again, favoured by the government) and service companies, and therefore, industry concentration is very low. In Russia, although the industry concentration is not as low as in Venezuela, this is primarily due to the government consolidation. Russian private, and at the same time Kremlin-friendly oil companies (Lukoil, Surgutneftegaz), government-owned companies (Gazprom, Rosneft), both of which “consider international majors as competitors,”\textsuperscript{1083} together with many service and consultancy firms, offer staunch competition to the IOCs. Therefore, whereas in the mid and late 1990s IOCs did not face much competition, in 2005/06, competition negatively affected their bargaining power in Iran, Russia and Venezuela.

Finally, in the oil industry, “reserve replacement is the best guide to whether a company will be able to maintain – or grow – production in the future.”\textsuperscript{1084} In 1998, five major IOCs replaced more oil reserves than they produced in the year, and their reserves grew by 3.7 percent when compared to 1998. However, they did not manage to replace all of the oil produced in 2005, and thus, between 2004 and 2005 their reserves dropped by 9.5 percent. Thus, as a consequence, while IOCs’ bargaining power vis-à-vis host states increased in 1998, it decreased considerably in 2005.

While these six factors are not exclusive, and many other variables, such as those outlined under ‘medium’ and ‘low’ in Table 7.1, affect higher host states’ bargaining power vis-à-vis IOCs in 2005/06 as compared to 1998/99, they are crucially important in explaining the return of the re-obsolescing bargain in the current decade.

**Hypothesis 2:**

*If the interests of American IOCs and the U.S. government are aligned, then the U.S. government supports American IOCs in bargaining with other actors. Related: If American IOCs receive support from the U.S. government from time to time, then this support results in bargaining success against other actors.*

The interests of American IOCs and the U.S. government were aligned in many bargaining cases studied in this dissertation. The U.S. government and major American IOCs were both in favour of IOC entry into Russia and Venezuela in the 1990s, and of U.S. government’s attempt to remove Chávez from power in Venezuela in 2002. Moreover, their interests were also aligned concerning the future of UNOCAL, and concerning increasingly unfavourable investment environment in Russia and Venezuela in 2006, as both sides would prefer these two countries to be more welcoming to foreign investment. However, their interests diverged concerning the U.S. government’s policy towards Iran, and were partially in line and partially in opposition concerning the future status of the ANWR. While the Bush administration and the IOC were supportive of opening ANWR for oil exploration, the Congress was opposed to this. Thus,


\textsuperscript{1082} Quoted in Marcel, *Oil Titans*, p. 213.

\textsuperscript{1083} Bahgat, “Russia’s Oil Potential: prospects and Implications,” p. 139.

\textsuperscript{1084} Schwartz, “A Shell of Itself.”
although at most times, their interests were aligned, the U.S. government did not actively support American IOCs in all such situations. For example, although the U.S. government actively supported U.S. IOCs in Russia in the 1990s, Venezuela in 2002, in the case of UNOCAL, and regarding ANWR (at least the Bush administration), this did not take place with regards to Venezuela and Russia in 2006. Not surprisingly, the U.S. government did not support American IOCs when their interests diverged, as in the case of Iran, and the lack of support in the Congress regarding ANWR drilling (see Figure 7.4).

Figure 7.4: U.S. Government’s Support for American IOCs as a Function of Their Interests

When the U.S. government supported American IOCs in their bargaining with other actors, on only two occasions did the IOCs emerge victorious. Firstly, Chevron benefited after receiving support from the U.S. government, and due to this support, which stemmed from political opposition to Chinese takeover of an American oil company, CNOOC withdrew from bidding. Secondly, Russia and Venezuela opened up their oil industries to foreign investment in the 1990s, after the U.S. pressured them to adopt an investment regime that eventually offered more protection, and bargaining power, to multinationals. American IOCs were certainly helped by the fact that in the mid and late 1990s, Russia and Venezuela suffered economically and were highly indebted. Since the U.S. has been the main creditor of their debt, one could assume that American IOCs received a degree of indirect help due to this development. On all other occasions, either when there was no U.S. government’s support for American IOCs (Iran; Russia and Venezuela in 2006; and no Congress’ support for ANWR drilling), or when there was support (Venezuela 2002; Bush administration’s support for ANWR drilling), the U.S. IOCs were unsuccessful in bargaining with other actors (see Figure 7.5). In Venezuela and Russia in recent years, American IOCs would not have gained bargaining power even if they were supported by the U.S. government. Any such support would have further deteriorated their

1085 Derived from Poynter’s assumption, that home nations can provide host nations with aid, money, military and economic support, or act as a supporter in multilateral organisations such as the World Bank, the United Nations, etc. Poynter, *Multinational Enterprises & Government Intervention*, p. 62.
bargaining power vis-à-vis Putin and Chávez, as Russia and Venezuela possess much more bargaining power vis-à-vis IOCs in the mid 2000s than they did in the 1990s (see Hypothesis 1). If the U.S. government applied pressure against them in the current decade, this would backfire, as it would clearly clash with their own interests and agendas. Similar scenario to that when the U.S. government supported a coup against Chávez in 2002 as support for American IOCs, would have occurred. This help backfired, and the U.S. government and American IOCs ended up facing much worse conditions in Venezuela than it was the case prior to the incident.

Figure 7.5: American IOCs’ Bargaining Success as a Function of the U.S. Government Support

Therefore, overall, we have a mixed result concerning both propositions, and one wonders what a possible explanation for this is? Whether the U.S. government’s and American IOCs’ interest are aligned; if so, does the U.S. government support U.S. IOCs; and if so, whether this support translates into bargaining victories for American IOCs, depends on the political context of each particular bargaining scenario. Political context in host states where American IOCs are present, domestic political context in the U.S., and American strategic security concerns affect the alignment of government and corporate interests, governmental support for these interests, and the outcome of that support (if any). However, one thing is certain – the major American IOCs do not hijack the U.S. government in order to further their own interests, and my findings deny the widespread conspiracy theories.

Hypothesis 3:

*If the NOCs from China are gaining bargaining power, then this is at the expense of the IOCs.*

The independent oil companies played a key role in weakening the bargaining position of major IOCs and in strengthening the bargaining power of the oil-exporting countries in the 1970s. Similarly, in the current decade, NOCs from oil importing countries, and in particular from China, weaken the bargaining position of major IOCs vis-à-vis host states and their NOCs. Although Chinese NOCs may not be gaining bargaining power vis-à-vis NOCs from the oil exporting countries, they are certainly competing with the IOCs, often triumph over them, and thus allow oil exporting countries and their NOCs to have a wider range of potential investors.
Thus, today, as in the 1970s, host governments are finding that they have an increasing number of options for securing the capital, technology, or access to markets they require, and individual IOCs have nothing like the bargaining position they held in the 1990s.

While IOCs primary objective is profit maximisation, oil-importing states’ NOCs are not ‘constrained’ by having to earn profits, and are backed by their respective governments, both financially and politically, in order to advance national policies. When a state-owned company steps out on the world stage, it does so with many critical and often quiet advantages, from diplomatic support to soft government loans, which it pays for by advancing the state’s agenda. In their quest for oil, supportive parent government policies are crucial in winning or losing in bargaining. Additionally, many oil-exporting states, which have NOCs of their own, such as Russia, Venezuela and Iran, often for ideological or practical reasons prefer dealing directly with oil importing governments through their NOCs, rather than with IOCs.

Chinese NOCs are spending billions of dollars on a global scramble for oil to feed China’s booming economy. They have the ability to obtain government loans at little or no interest (see Chapter 5, case study 4). Driven by government’s energy security policy, which is aimed at developing multiple import sources and routes (diversification primarily away from the Middle East) and building up reserves to avoid unexpected interruption, China’s NOCs have acquired growing equity oil stakes and long-term crude oil contracts, and have signed ‘strategic’ alliances in many regions of the world. By March 2007, China, through its three companies, had signed oil and gas deals, or had oil and gas assets or interests in (or with) not less than 63 countries. In doing so, they have emerged victorious vis-à-vis major IOCs in various oil bargaining situations and have provided IOCs with unwanted competition in many oil-producing countries.

For example, CNPC outbid Amoco (now owned by BP), Chevron and Exxon Mobil for interest in the second-largest oil field in Kazakhstan in 1997. Further, Sinopec has won the right to explore for hydrocarbons in Saudi Arabia’s al-Khali Basin outbidding Chevron, in what, according to some American analysts, was a proof that China has been building a special relationship with Saudi Arabia, a traditional U.S. ally in the Middle East, in order to compete with the U.S. for influence in the region. Moreover, Chinese officials locked up long-term


1090 Key countries in bold, strategic alliances with underlined countries: Algeria, Angola, Argentina, Australia, Azerbaijan, Bangladesh, Bolivia, Brazil, Brunei, Cameroon, Canada, Chad, Colombia, Congo (Republic of), Cote D’Ivoire, Cuba, Ecuador, Egypt, Equatorial Guinea, Ethiopia, Gabon, India, Indonesia, Iran, Iraq, Italy, Kazakhstan, Kenya, Kuwait, Kyrgyzstan, Libya, Madagascar, Malaysia, Mauritania, Mexico, Mongolia, Morocco, Mozambique, Myanmar, Niger, Nigeria, Oman, Pakistan, Papua New Guinea, Peru, the Philippines, Russia, Saudi Arabia, Somalia, Sudan, Syria, Taiwan, Thailand, Tunisia, Turkmenistan, the United Arab Emirates, the United States, Uzbekistan, Venezuela, Vietnam, Yemen, and Zimbabwe.


contracts for Alberta’s oil sands in Canada, while outbidding IOCs.\textsuperscript{1093} Sinopec has been successful in outbidding many IOCs in Angola in May 2006 by winning a 40 percent stake in an area off the coast of Angola, Block 18, after proposing a record-breaking $1.1 billion government signature bonus.\textsuperscript{1094} Additionally, China also acquired oil assets in Ecuador where operations of Occidental, an American IOC have recently been nationalised, and as evident from Chapter 4, Chinese oil officials signed various agreements with Venezuela, which include ambitious plans to sell large amounts of oil to China, possibly at the expense of U.S. oil imports from Venezuela.\textsuperscript{1095} In 2004, China and Iran signed a $100 billion oil and natural gas deal, which could total $200 billion over 25 years,\textsuperscript{1096} and which undermined a decades-long U.S. economic embargo of Iran (see Chapter 5). It also reduced Iran’s need for IOC investment in the country. In August 2005 we witnessed China’s (through CNPC) largest ever cross-border takeover, of PetroKazakhstan, a Canadian-based firm with a market value of $3.5 billion,\textsuperscript{1097} with energy assets in the Central Asian country. CNPC acquired PetroKazakhstan for $4.2 billion, thus outbidding by $700 million.\textsuperscript{1098} Unsurprisingly, IOCs came nowhere close to winning the bid. Similarly, in January 2006, CNOOC acquired oil and gas assets in Nigeria for $2.27 billion, increasing competition in a country where most of major IOCs are present.\textsuperscript{1099} Finally, in Russia, where IOCs are increasingly unwelcome, Chinese NOCs have recently become more active. For example, in November 2006, Rosneft and Sinopec signed a deal to buy Udmurtneft, a Russian oil company, and also in late 2006, a partnership between Rosneft and Sinopec has resulted in a first exploration well on the Sakhalin-3 block, offshore Sakhalin Island. This was the first time the two countries have cooperated in an upstream oil project on Russian territory (see Chapter 3).

Chinese NOCs’ success is further exacerbated by the fact that in general, oil importing countries’ NOCs are often favoured by host governments since, according to John Mitchell and Glada Lahn, they “carry less ‘imperialist’ baggage than Western governments or companies”.\textsuperscript{1100} Thus, according to Marcel, investment from foreign NOCs, rather than IOCs, is politically more palatable for the host government. In relation, she argues that due to “cultural proximity between NOCs and host countries,” NOCs can better understand how to work through a bureaucratic system of a host country than IOCs.\textsuperscript{1101} Moreover, many host governments, such as Sudan, Myanmar, Iran, and others, are attracted by the fact that China’s government agencies and financial institutions do not apply conditions, such as the UN Global Compact, regarding transparency and external monitoring of operations affecting human rights and ethical issues to loans and aid packages associated with oil deals.\textsuperscript{1102} Therefore, oil importing countries’ NOCs are

\textsuperscript{1098} “The World This Week,” \textit{The Economist}, August 27, 2005, p. 7.
\textsuperscript{1099} Ibid. For more detail on China's oil deals in Africa, see Vivienne Walt, “China’s African Safari,” \textit{Fortune}, February 20, 2006, pp. 68-73.
\textsuperscript{1100} Mitchell and Lahn, “Oil for Asia,” p. 9.
\textsuperscript{1101} Marcel, “Investment in Middle East Oil,” pp. 11-3; and Marcel, \textit{Oil Titans}, p. 71.
\textsuperscript{1102} Mitchell and Lahn, “Oil for Asia,” p. 9.
clearly advantaged vis-à-vis major IOCs in their dealings with host governments and this is clearly evident in Venezuela and Iran’s favouring of Chinese and other NOCs.

Results of Chinese NOCs’ success against the IOCs are evident in Table 7.2 and 7.3. While in 2005, five major IOCs did not manage to replace their reserves, and their overall reserves dropped by 9.6 percent, when compared to 2004, Chinese NOCs’ reserves increased by 1.4 percent (Table 7.2). Moreover, while major IOCs’ Reserves/Production (R/P) ratio dropped by 1.3 years between 2004 and 2005, Chinese NOCs’ R/P ratio dropped by only 0.2 years in the same period (Table 7.3). I already established that major IOCs’ reserve replacement is an important indicator of their bargaining power, as in the oil industry, “reserve replacement is the best guide to whether a company will be able to maintain – or grow – production in the future.” A sharp decrease in IOCs’ R/P ratio also portrays their diminishing bargaining power. Thus, since major IOCs did not manage to replace all of their production in 2005, and Chinese NOCs replaced more than they produced, and their R/P ratio dropped marginally when compared to that of major IOCs, this indicates that IOCs are losing their bargaining power at the expense of Chinese NOCs. This is also evident from examples presented above, as Chinese NOCs are clearly establishing their presence in many oil-exporting countries at the expense of Western IOCs. In recent years, CNPC, Sinopec, and CNOOC achieved impressive gains in their foreign ventures despite re-nationalisation steps being taken in the energy sectors of several oil-exporting nations, including Russia and Venezuela.

Table 7.2: Major IOCs’ and Chinese NOCs’ Oil Reserves (2004 and 2005)

<table>
<thead>
<tr>
<th></th>
<th>Reserves (billion barrels)</th>
<th>Balance (2005-2004; billion barrels)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2004</td>
<td>2005</td>
</tr>
<tr>
<td>Exxon Mobil</td>
<td>11.651</td>
<td>11.229</td>
</tr>
<tr>
<td>BP</td>
<td>7.550</td>
<td>7.161</td>
</tr>
<tr>
<td>Total</td>
<td>7.003</td>
<td>6.592</td>
</tr>
<tr>
<td>Chevron</td>
<td>5.511</td>
<td>3.626</td>
</tr>
<tr>
<td>Royal Dutch/Shell</td>
<td>3.745</td>
<td>3.466</td>
</tr>
<tr>
<td><strong>Total Majors</strong></td>
<td><strong>35.460</strong></td>
<td><strong>32.074</strong></td>
</tr>
<tr>
<td>CNPC</td>
<td>11.704</td>
<td>11.745</td>
</tr>
<tr>
<td>Sinopec</td>
<td>3.267</td>
<td>3.294</td>
</tr>
<tr>
<td>CNOOC</td>
<td>2.200</td>
<td>2.373</td>
</tr>
<tr>
<td><strong>Total Chinese NOCs</strong></td>
<td><strong>17.171</strong></td>
<td><strong>17.412</strong></td>
</tr>
</tbody>
</table>


Table 7.3: Major IOCs’ and Chinese NOCs’ R/P Ratios (2004 and 2005)

<table>
<thead>
<tr>
<th></th>
<th>R/P Ratio (2004; years)</th>
<th>R/P Ratio (2005; years)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Exxon Mobil</td>
<td>12.4</td>
<td>12.2</td>
</tr>
<tr>
<td>BP</td>
<td>8.2</td>
<td>7.7</td>
</tr>
<tr>
<td>Total</td>
<td>11.3</td>
<td>7.3</td>
</tr>
<tr>
<td>Chevron</td>
<td>8.8</td>
<td>6.0</td>
</tr>
<tr>
<td>Royal Dutch/Shell</td>
<td>4.7</td>
<td>4.8</td>
</tr>
<tr>
<td><strong>Total Majors</strong></td>
<td><strong>9.1</strong></td>
<td><strong>7.8</strong></td>
</tr>
<tr>
<td>CNPC</td>
<td>15.3</td>
<td>15.2</td>
</tr>
</tbody>
</table>

1103 Schwartz, “A Shell of Itself.”
Sinopec | 11.6 | 11.5  
CNOOC  | 12.4 | 11.8  
**Total Chinese NOCs** | **14.0** | **13.8**  


Only once in recent years were the Chinese NOCs defeated by major IOCs. To repeat what was outlined in Chapter 5, in June 2005, by offering $18.5 billion for UNOCAL, one of the biggest independents in the United States,\(^{1104}\) CNOOC outbid Chevron by $2 billion. Price, therefore, did not matter for CNOOC. Chevron raised the stakes in July 2005, by upping its bid to $17 billion, and despite the statement that “if the People’s Republic of China wishes to acquire UNOCAL, it will,”\(^{1105}\) the largest foreign takeover yet attempted by a Chinese firm did not finalise due to political opposition in the United States. Many critics in the U.S. suggested that CNOOC would be paying too high a price for UNOCAL and that the money was coming directly from China’s government.\(^{1106}\) Stephen Lewis argued that the outcome of CNOOC-UNOCAL case “is not indicative of the general ability of Chinese national oil companies overall to compete with most multinational oil and gas companies.”\(^{1107}\) Thus, due to political interference from the U.S. government, the UNOCAL case was an exception to the recent Chinese bargaining superiority vis-à-vis IOCs.

Thus, most findings are supportive of the hypothesis. Evidence from Iran, Russia, and Venezuela, and many other countries, not directly examined in this dissertation, illustrates that Chinese NOCs are gaining bargaining power at the expense of major IOCs. Bargaining for UNOCAL is the only case that goes against this evidence, as Chevron gained bargaining power vis-à-vis CNOOC after much domestic opposition against Chinese takeover of an American oil company (see Figure 7.6).

**Figure 7.6: IOCs’ Bargaining Power Relative to Bargaining Power of China’s NOCs**

\(^{1104}\) In 2005, UNOCAL was the 12\(^{th}\) largest oil company with the headquarters in the United States. “The Forbes Global 2000.”


In summary, with a rapidly growing economy and as oil imports continue to increase, China spends billions to acquire oil assets abroad, and by applying neo-mercantilist methods (for example, by buying ‘equity’ oil), it is trying to limit its reliance on oil markets. In a bid to offset growing energy demand, China, through its NOCs, has secured deals on Canadian oil sands, Latin America, Central Asia and the Middle East and Africa. Chinese NOCs are known to overbid to acquire contracts to feed China’s rapidly energy-hungry economy. Most of the time, with the exception of UNOCAL case, overbidding has helped Chinese NOCs secure deals at the expense of other companies. Since they are powerful new players, other players must make room for China and its NOCs in the international energy markets. Due to their cultural proximity and since they do not carry imperialist baggage, host governments prefer Chinese NOCs to IOCs. Western majors, who are already finding it hard to replace their oil reserves (Table 7.2), see the emergence of new Chinese rivals as a sign of difficulties ahead. As a sign of things to come, it is interesting to note that in 2006, PetroChina reported a net income larger than that made by IOCs such as Chevron or Total, and market value higher than all major IOCs but Exxon Mobil. In its global pursuit of oil to fuel its economic growth, China has strengthened bonds with countries distinctly inimical to American interests, including Venezuela, Sudan, Syria, Zimbabwe and most crucially Iran. Besides expanding their drilling in countries where armed conflicts, corruption and instability have kept Westerners at bay, Chinese NOCs are expanding their drilling across areas where Chevron, Royal Dutch/Shell, Exxon Mobil, BP, Conoco Phillips and Total have long been dominant, thus reducing their bargaining power vis-à-vis host states. They are able to achieve this since they possess the ability to overspend to secure contracts, and are not driven exclusively by profit maximisation.

Hypothesis 4:

If a major oil-importing government’s oil supply security is perceived as threatened when bargaining with other actors, then this government will not emerge victorious from bargaining.

In cases examined in this dissertation, governments of major oil-importing countries, the U.S., Japan, and China, when engaged in bargaining with other actors, at most times perceived their oil

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1108 Mihailescu, “U.S. Watches China’s Oil Demand, Deals.”
supply security as threatened. The U.S. government perceived American oil supply security as threatened in bargaining for UNOCAL, as China got close to acquiring an American company in control of oil reserves in the Gulf of Mexico and Canada, among other places. The U.S. government’s support for Chevron, and resistance to the Chinese takeover of UNOCAL, showed that in bargaining with the Chinese, the government was more interested in oil supply security rather than in the free functioning of the market. Oil supply security was the main rationale for the Bush administration in bargaining for future of the ANWR, since by opening up the ANWR for exploration and production, the U.S. government aimed to increase domestic oil production and therefore reduce dependence on foreign oil. Likewise, in Venezuela, which was, and still is, one of the most important oil suppliers to the United States, the U.S. government is primarily interested in friendly regime being in power, as this would ensure secure oil supplies in the future. The Japanese government perceived Japan’s oil supply security as threatened when bargaining over Azadegan oilfield in Iran, since in past, Iran had been a major source of Japanese oil imports. Likewise, due to its surging demand for imported oil, China’s government perceived Chinese oil supply security as threatened in all bargaining cases – UNOCAL, Venezuela, Iran, and the Russian Far Eastern pipeline. China’s concerns over its oil supply security are of very high importance, as its continued high economic growth rates depend on oil supply growth. If oil supply growth were slowed down, China’s economy would also slow down, and since the CCP’s domestic legitimacy depends on steady economic growth, it must secure additional oil supplies.

In the above cases, three major oil-importing governments have had mixed bargaining success. The U.S. government was successful in the case of UNOCAL, and Bush administration failed so far regarding ANWR. The Japanese government failed in Iran, and the Chinese government succeeded in Iran, Venezuela, and most likely in the case of bargaining for the priority route of the Russian Far Eastern pipeline; while it failed in the case of UNOCAL (see Figure 7.7). There were three cases in which governments of major oil-importing countries did not perceive oil supply security as threatened. Firstly, the U.S. government was more concerned with Iranian nuclear issue than with Iranian oil. Secondly, the U.S. Congress was more concerned with environmental factors (preserving a pristine wildlife area) rather than drilling for oil in ANWR. Finally, the Japanese government kept the issue of Kuril Islands in its relationship with Russia above anything else, and until this issue is resolved, there will be no drastic improvement in Russo-Japanese relationship. In these three cases, we have had a mixed bargaining success for these actors. While the Alaska Coalition, helped by the U.S. Congress, so far successfully defeated the Arctic Power, the U.S. government as a whole did not manage to slow down or stop the Iranian nuclear programme, and Japan has so far been on the losing end of bargaining for Russian Far Eastern pipeline’s priority route (Figure 7.7).

Figure 7.7: Oil-importing Government’s Bargaining Success as a Function of Oil Supply Security Threat Perception
Thus, despite of the fact that at times when oil supply security is perceived as threatened, major oil-importing governments invest considerable resources in order to achieve a positive bargaining outcome, they often fail to do so. In such situations, they often face equally determined opponents, to whom, at most times, oil supply security is also a crucial concern. In Venezuela, the U.S. government has had to deal with highly determined president Chávez, and oil-starved China. Domestically, in the case of ANWR bargaining, the Bush administration had not been able to defeat the resolute Alaska Coalition, which has had crucial support in the Congress. China, through CNOOC, has been unable to purchase a mid-sized American oil company (UNOCAL), due to firm opposition by the U.S. government. Finally, Japan has not been able to secure the Azadegan deal, due to heavy American pressure to pull out.

**Hypothesis 5:**

*If oil-exporting states use oil, explicitly or tacitly, in their bargaining with other actors, then they do not gain concessions in other bargaining arenas.*

In my discussion of validity of the previous hypothesis, one of the findings was that thus far, the U.S. government has not been successful in its nuclear bargaining with Iran. Has this been the case because Iran used its oil to gain concessions from other states in order to reduce the American pressure against its nuclear programme? Have any other oil-exporting states studied in this dissertation, such as Russia and Venezuela, used oil in order to gain concessions from other states? Iran has repeatedly threatened to cut off oil exports if comprehensive economic sanctions are imposed due to its nuclear activities. Russia has used the prospect of substantial energy exports from eastern Siberia and the Russian Far East to markets in East Asia to make itself a major factor in the foreign policies of both China and Japan, playing on their interests in order to receive concessions. Similarly, Chávez has repeatedly threatened an oil-export embargo against the United States, and has used oil to lure China, and to build an alliance of friendly regimes throughout Latin America.

Both Iran and Venezuela are cultivating oil relationships with nations that are in a position to block economic sanctions or provide other political assistance. According to an Independent
Task Force of U.S. Council on Foreign Relations (CFR), the United States has a reduced freedom of action and influence in the conduct of its foreign affairs. This is so since “the revenues and dependencies in the world oil market empower oil-rich countries – such as Iran and Venezuela – to carry out foreign policies that are hostile to that of the United States.”

Iran’s key role in the global oil market protects it from draconian economic measures being taken against its energy sector. The control over enormous oil reserves gives Iran the flexibility to adopt policies that oppose U.S. interests and values, and allows it to proceed with its nuclear program, which is aimed at securing regime stability from outside threats. Since Iran’s outright and explicit use of the oil weapon would put its longer-term interests at risk (in terms of lost revenue and market share), and would compromise the regime stability, since its economy is too fragile for its leaders to risk an oil freeze, Iran tacitly uses the oil weapon to further its interests. It is oil that helps Iran in gaining crucial support from China in the international arena. China’s UN Security Council veto power protects Iran from any comprehensive sanctions. Further, Chinese investment in Iranian oil industry allows Iran to maintain or increase its oil export revenues, high levels of which are essential for Iranian leaders to ‘buy’ domestic stability. Moreover, Iran has successfully used Europe’s reliance on its oil in order to break up the transatlantic alliance. Thus, Europe’s Iran policy largely differs from the American Iran policy. Finally, Iran successfully uses threats of taking oil off the market to increase its oil export revenues and to warn other states not to take any economic or military action against Iran. For example, Ayatollah Khamenei’s comments in June 2006 that Iran could counter economic sanctions by stopping their and other Persian Gulf countries’ oil exports, lifted crude prices by nearly 80 cents a barrel, and ensured that no comprehensive economic sanctions were imposed against the regime.

Venezuela has so far been successful in ensuring regime stability from both domestic and international threats, and spreading the ‘Bolivarian Revolution’ to the rest of Latin America by engaging in oil diplomacy. Chávez has so far managed to avoid a U.S. instigated regime change as, in order to deter any U.S. attempts at regime change, he threatened to reduce Venezuela’s oil exports to the United States, and CITGO’s downstream presence there. By selling oil to China, Venezuela can demonstrate its seriousness about reducing oil exports to the United States. At times of high prices and tight oil markets, the U.S. can do nothing in retaliation. Chávez also uses oil export revenues for maintaining domestic regime stability, and offers cheap oil for international political support. By using oil export revenues, Venezuela has been inviting realignment in Latin American political relationships, by for example, funding Argentina’s exit from its IMF standby agreement and Bolivia’s oil and gas nationalisation. In addition, since the U.S. government is unable to offer any support to the American IOCs present in Venezuela, Chávez often demands, and generally gains concessions from weak American IOCs present in the country, which due to the lack of alternative investment opportunities, have no choice but to acquiesce to his demand and remain loyal.

Finally, Russia has gained concessions from China in bargaining over the priority route of its Far Eastern pipeline. In December 2005, China transferred $6 billion for future oil deliveries that were used to help Rosneft, a state-owned oil company, buy Yuganskneftegaz. Moreover, Russia has successfully ignored Western attitudes in opposing its oil industry re-nationalisation and the overall movement to authoritarianism, in large part because of confidence provided by large oil export revenues and tight oil markets, which make Western all out confrontation with Russia

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110 In my previous research, I found that Iran uses threats to enhance regime stability. See Vlado Vivoda, “Threats, Bargaining and Regime Stability: A Study of Strategic Bargaining between Oil Producers and Consumers,” M.A. thesis, Department of International Relations, Research School of Pacific and Asian Studies, Australian National University, October 2004.
unlikely. Thus far, Japan is the only country from which Russia failed to gain any concessions by using oil, tacitly or explicitly. Japan refuses to put the issue of Kuril Islands aside, and this significantly reduces its chances of Russia prioritising the ‘Japan’ route in the construction of Far Eastern pipeline.

In summary, in all but one of the cases examined above, oil-exporting states that use oil, explicitly or tacitly, in bargaining with other actors, gain concessions in other bargaining arenas (see Figure 7.8). This illustrates that the oil weapon, albeit in a tacit form, is a potent bargaining tool for oil-exporting states to gain concessions from actors dependent on that oil.

**Figure 7.8: Concessions as a Function of Oil-exporting States’ Use of Oil as a Bargaining Tool**

![Diagram showing concessions as a function of oil-exporting states' use of oil as a bargaining tool]

**Conclusion**

In this chapter, after briefly summarising the findings, I revisited all of the hypotheses established in Chapter 2, and discussed their validity. Out of five hypotheses, the validity of the first one is certainly the most important finding. In discussing the first hypothesis, I found that due to their weak bargaining power, the IOCs have been on the losing side in their bargaining with oil exporting countries and/or their NOCs in the current decade when compared to the 1990s, and thus, we are witnessing the return of the obsolescing bargain and resource nationalism. Due to the nature and importance of this finding, this hypothesis received disproportionate attention when compared to all others. The second finding is that China’s NOCs weaken the bargaining position of major IOCs vis-à-vis host states and their NOCs. Third, I found that American IOCs’ and the U.S. government’s interests are not exclusively aligned, and that the U.S. government only occasionally supports American IOCs in bargaining with other actors. In relation, I found that if American IOCs receive support from the U.S. government from time to time, then this support does not necessarily result in bargaining success against other actors. Fourth, if a major oil-importing government’s oil supply security is perceived as threatened when bargaining with other actors, I found that this government would not necessarily emerge victorious from bargaining. Finally, if oil-exporting states use oil, explicitly or tacitly, in their bargaining with other actors, at most times they gain concessions in other bargaining arenas.
CONTRIBUTION TO KNOWLEDGE, POLICY IMPLICATIONS, AND HEURISTIC VALUE

Based on the findings presented in Chapter 7, in this chapter I outline the ways in which this dissertation contributes to extant literature, both theoretically and empirically. The main way in which this study contributes to present knowledge is that, by developing a new model of studying host state-MNC bargaining power relationship, it suggests that IOCs’ bargaining power vis-à-vis host governments has re-obsolesced. This and various other contributions are discussed in some detail in the first section. In addition, based on the main findings from Chapter 7, in the second section I outline policy implications for major actors in the oil industry, paying particular attention to Western governments and IOCs, and to NOCs and their home governments. Finally, I propose various directions for further research.

8.1 The Original Contribution to Knowledge

I am unaware of anyone who attempted to study oil through examining bargaining relationships among various industry actors. Studying oil through a bargaining lens was crucial for understanding the contemporary balance of power between major players in the oil industry. Moreover, by outlining various theoretical propositions (see Chapter 7) this study has sought to establish a solid foundation for any further studies of this nature. The concept of issue linkage helped us appreciate that concerns related to oil are at the heart of world politics, intersecting with just about every significant contemporary global issue, which was evident from the vast ground that was covered in the case study chapters. For example, this was evident in the complexity of Russia’s Far Eastern pipeline bargaining, or Iranian oil industry bargaining, which is ‘nested’ within the overall nuclear bargaining. It also showed how much can be learnt about the changing nature of politics through the study of oil. Since it represents a crucible for exploring the intersection of political economy, development, foreign policy, and international cooperation, oil offers a starting point for asking more profound questions about the changing nature and conceptualisation of contemporary world politics.

Conceptualising the oil markets as politicised was clearly helpful, as political considerations were found to be least as important as economic considerations in all bargaining scenarios examined in this study. This was evident in both domestic and pipeline bargaining in Russia, oil industry bargaining in Venezuela, bargaining for UNOCAL, bargaining for drilling rights in the ANWR, and from oil and nuclear bargaining in Iran. This further reinforces the widely held view that oil is a highly politicised commodity, and leads one to stress the importance of including political considerations into any future analysis of oil markets.

Research on host state-MNC bargaining power relationship indicated that empirical findings on the specific determinants of MNC bargaining power are too divergent, and sometimes incomparable to draw systematic conclusions and provide meaningful implications. Different theoretical perspectives for predicting and explaining particular sources of bargaining power provide only partial slices of reality. Thus, there was a need for a more integrative theoretical
framework within which the MNC (and IOC) bargaining power phenomenon can be understood. Furthermore, MNC bargaining power has not been systematically linked to MNC performance within the host country operations. On both theoretical and empirical fronts, the linkage between bargaining power and firm performance was not systematically investigated. This gap constituted a critical error of omission since MNCs seek a stronger bargaining power position in order to reach successful bargaining outcomes in the host country. Both aforementioned gaps – lack of a broader theoretical framework and lack of connection between bargaining power and firm performance – motivated me to propose a new theoretical model (Figure 2.3, and Appendix 1). With its explicit focus on firm's internal resources, and country and industry specific context as sources of, and factors affecting the bargaining outcome, this framework not only makes a theoretical connection between bargaining power and performance, but also provides a coherent theory for understanding bargaining power relationship within a broader theoretical framework.

This model extends the implications of Vernon’s ‘obsolescing bargain’ hypothesis in new ways. The gist of this hypothesis is that even if some firm-specific resources provide an MNC with a strong bargaining position initially, they may not do so in the future because the value of such resources may eventually diminish, as they are absorbed and/or replicated by host country partners, personnel, and government agencies. Accordingly, MNC investments and any advantages from such investments can be duplicated by host government agencies and local firms, leading to the erosion of MNC bargaining power. While my model converges with the obsolescing bargain hypothesis in recognising the dynamic nature of bargaining power, it also sheds additional light by introducing further conditions (industry competition, high commodity prices, lack of alternative options, etc.) under which an MNC’s (or IOC’s) bargaining power is likely to diminish, to be maintained or enhanced over time.

Although the focus of this book is on studying the political aspect of the relationship between actors in an economic issue area, and as such, it belongs to the field of the International Political Economy (IPE). By studying bargaining, this study also intersects with the International Business Studies (IBS), and international bargaining and negotiation analysis literature. Thus, since I study bargaining between various actors in the international political economy, this study provides a bridge between IPE and international bargaining and negotiation analysis. Given that I utilise various studies from the International Business Studies (IBS) literature in analysing the relationship between governments and multinational corporations, this study also provides an important and previously missing link between the IPE and IBS literature.

Further, after studying six oil industry bargaining scenarios in four different countries in order to test the hypotheses, the following theoretical propositions, all of which have been discussed in more detail in Chapter 7, can be put forward:

1) Due to their weak relative bargaining power, the IOCs have been on the losing side in their bargaining with oil exporting countries and/or their NOCs in the current decade when compared to the late 1990s, and thus, we are witnessing the return of the obsolescing bargain.

2) The interests of American IOCs and the U.S. Government are not exclusively aligned. When they are aligned, the U.S. Government does not necessarily support American IOCs in bargaining with other actors. If American IOCs receive support from the U.S. Government from time to time, then this support does not always result in bargaining success against other actors.

3) The NOCs from China are gaining bargaining power at the expense of the IOCs.

4) When a major oil-importing government’s oil supply security is perceived as threatened when bargaining with other actors, then this government would not necessarily emerge victorious from bargaining.
5) Oil-exporting states use oil, explicitly or tacitly, in their bargaining with other actors. When this is the case, they at most times gain concessions in other bargaining arenas.

These propositions advance both our empirical and theoretical understanding of the oil industry and bargaining literature in a number of ways. First, it is very likely that we are going to witness further decline, if not the end, of ‘Big Oil’, and that it may be very difficult for the major IOCs to rebound from their current lows. Second, we are able to analyse which exact factors are to be blamed for current IOC decline. Third, the bargaining model I established in order to assess temporal variation in IOCs’ bargaining power vis-à-vis host states upgrades the obsolescing bargain model, and may be useful in testing temporal variation in bargaining power among MNCs and host states in various extractive industry scenarios. Fourth, since by using oil as a bargaining chip oil exporters are at most times able to gain concessions from actors in other bargaining arenas we may predict that under current market conditions, Iran may be able to continue its pursuit of nuclear technology, and Hugo Chávez may successfully spread his Bolivarian Revolution to the rest of Latin America. Fifth, assessing the relationship between the U.S. government and American IOCs, and how this relationship translates in bargaining outcomes for American IOCs, enabled us to disprove the ‘urban myth’, which assumes close connection between the U.S. government and Big Oil, and also furthers our theoretical understanding of home government-corporate relationship. Sixth, examining whether governments of major oil importing countries are successful in bargaining with other actors when their oil supply security is perceived as threatened helps us understand their actual bargaining power vis-à-vis oil exporters and other actors in both domestic and international politics. Finally, since China’s NOCs are indeed gaining bargaining power vis-à-vis the IOCs, nationalisation, or at least closer home government-corporate alliance, may be the best way forward to salvage major Western IOCs. In the following section, I suggest some future policy directions and implications for various actors in the oil industry, which follow from these findings.

8.2 Policy Implications

Western Governments and IOCs

In order to reduce strategic competition for oil with China, and increasingly India, some argue that a step Washington and other Western governments should take is to facilitate broader and deeper cooperation between the IEA and China and India. However, because these states are not members of the OECD, they are not formally eligible for membership in the IEA, and they have not yet built up the minimum levels of stockpiled oil and petroleum products defined by the IEA for its members. Notwithstanding the existing barriers, one can suggest that it could be in the interest of the United States and its Western partners to establish much closer coordination between emerging Asian economies and the IEA. This would have particular importance so to influence these states to be more reliant on international markets and less on government-to-government supply deals to meet their energy needs.

However, a widely held perception within the Chinese establishment – that the international oil market is a foreign (primarily American) construction, operated by Western IOCs in accordance with their interests, and that China cannot bet its energy security on that construction – will be extremely difficult to change. Thus, the abovementioned cooperation between the IEA and China (and India) will be extremely difficult to achieve under current circumstances. This is particularly so when China considers the resistance from the U.S. Congress to CNOOC’s

potential acquisition of UNOCAL in mid-2005, and the fact that in May 2003 both CNOOC and Sinopec were blocked from participating in the development of an oil field in the Caspian Sea at the expense of mainly Anglo-American companies, who increased their stakes.\footnote{1112}

In a perfect \textit{laissez faire} world, all NOCs would be privatised and foreign investors treated the same as local companies.\footnote{1113} This is the U.S. government’s ‘dream’ world. However, oil-exporting governments will never purposefully impoverish themselves and agree to this state of affairs. Thus, the U.S. policy should reflect this fundamental reality, and the U.S. government should accept the existence of NOCs as a fact. Rather than pressing oil exporters to free their NOCs from government interference and to increase the part played by foreign private investors, as this kind of pressure often alienates oil-exporting countries, the U.S. government should assume an alternative strategy.

The emerging trend of downstream and especially upstream internationalisation of NOCs is very threatening to IOCs. The NOCs are challenging the IOCs on their own turf, as most NOCs nowadays have international activities. As a result, there is a blurring of categories between IOCs and NOCs, as many NOCs are becoming ‘hybrids’, and are increasingly competitive with the IOCs. Therefore, the major question that the Western oil importing countries should ask themselves is why not rely on NOCs to supply energy to markets? Instead of relying on NOCs (or NOC-hybrids) to supply energy to their markets, Western oil importing countries should strongly consider turning IOCs based in their countries into hybrids in order to be able to compete more successfully with NOCs from both oil-exporting and importing countries. A case in point is the support Chevron received from the U.S. Congress in its bid for UNOCAL. Major American IOCs, such as Exxon Mobil, Chevron, and Conoco Phillips, need higher U.S. Government control.\footnote{1114} Since some have suggested that “it is impractical for the U.S. government to reverse the trend toward national control [of oil industry],”\footnote{1115} then why not join this trend?

Western IOCs face a variety of problems: booking additional reserves; maintaining market share at home and internationally; establishing new overseas markets; protecting future demand for hydrocarbons; responding to new environmental regulations in the consuming countries; and responding to increasing competition from NOCs and service companies. Valérie Marcel argued that in future, the “industry environment is set to become even more challenging for the IOCs.”\footnote{1116} In order to tackle this ever more challenging environment, Western governments should help their IOCs by limiting foreign oil company presence in both local upstream and particularly downstream operations. This would provide these IOCs with more certainty and security at home. Moreover, maintaining old overseas markets and establishing new ones, as well as booking additional reserves could be enhanced by home government control. The recent success of China’s NOCs vis-à-vis Western IOCs (see the Hypothesis 3 discussion) illustrates the need for increased government control in order to compete with the Chinese more successfully.

For example, hybrid and government-controlled IOCs would likely be more successful in their overseas bargaining with Central Asian and African countries, which are not fully closed to

\footnotesize\begin{itemize}
  \item \footnote{1113} Barnes, “NOCs and U.S. Foreign Policy,” p. 22.
  \item \footnote{1114} The idea of an American NOC is not new. Internationally, the United States came close to creating its own NOC during World War II. Called the Petroleum Reserves Corporation, it was promoted by secretary of the \textit{Inter}ior Harold Ickes and supported by the military as a means to ensure access to foreign oil reserves (particularly in Saudi Arabia) through direct ownership of the U.S. government. \textit{Yergin, The Prize}, pp. 397-9.
  \item \footnote{1115} Council on Foreign Relations, “National Security Consequences of U.S. Oil Dependency,” p. 49
  \item \footnote{1116} E-mail correspondence with Valérie Marcel, October 31, 2006.
\end{itemize}
foreign investment. Moreover, the U.S. and U.K. governments could then apply some explicit pressure on the Iraqi government, so that their hybrids/IOCs get preferential and highly profitable deals when bargaining with the Iraqi government over new agreements. Simon Bromley argues that ‘regime change’ in Baghdad provides an opportunity to create a suitable investment climate for U.S. oil companies. If American or British IOCs invested in Iraq if the overall security situation improves, this would likely involve PSAs in which INOC retains legal title to the reserves and the foreign investor is remunerated by ‘cost oil’ – that is, oil sold at market prices to cover its costs – and by an agreed share of the remaining ‘profit oil.’ Given the lack of link between U.S. government interests and Big Oil interests, there would be a high possibility that some future Iraqi government would bargain as tough as any other oil-producing state, unilaterally change the agreements, and possibly expropriate the IOCs’ assets, similar to recent developments in Venezuela and Russia. Thus, governmental control over IOCs would increase IOCs’ future chance of success in Iraq, as they would be directly supported by the U.S. and U.K. governments. Gaining access to overseas reserves in Iraq and elsewhere, and therefore improving their upstream position, would help Western hybrids to reduce operational imbalances, provide a basis for future cash flows and profits, and reduce the political power of the NOCs.

Besides exercising more control over their IOCs, Western governments should encourage and subsidise the long-term development and use of alternative, both renewable and non-renewable sources of energy. This is something the U.S. government, and Bush administration in particular, unlike many European governments, has not been pursuing to a great extent. According to Ran Goel, this is because “American oil companies are key players in limiting the enactment of domestic energy policy aimed at curbing fossil fuel use,” and “consequently, the American government’s ability to manage petroleum demand is severely restricted.” The U.S. government should strive to reduce American dependence on imported oil, not by opening up for drilling new, ecologically sensitive areas such as the ANWR to the IOC preference, but by encouraging energy efficiency and conservation, and investing in alternative energy. This would ultimately lead to a clash with IOCs, and most likely trigger conflict between the IOCs and the U.S. government. However, the conflict could be resolved by reaching a ‘grand bargain’. In this bargain, on one hand, the U.S. government should set to support and protect its hybrid IOCs domestically, by monopolising upstream and downstream activities; and internationally (discussed in the previous paragraph). Moreover, the U.S. government should help them to bring

1117 I thank Valérie Marcel for this point.
1119 After the occupation of Iraq, oil companies made it clear that they would not commit themselves to invest because of the overall security situation, and the risk associated with it. Ibid, p. 428; and A.F. Alhajji, “The U.S. Energy Policy and the Invasion of Iraq: Does Oil Matter?” paper presented at the 30th Annual Energy Conference, Center for Energy and Development, Boulder, CO., April 2003, pp. 19-21. Political instability and fears about the safety of personnel have forced major oil companies to delay sending their representatives to Baghdad. Sir Philip Watts, chairman of Royal Dutch/Shell amplified these concerns in July 2003 by saying “The safety of our people is paramount. There has to be proper security, legitimate authority and legitimate process . . . by which we will be able to negotiate agreements that would be longstanding for decades. We would not go into that situation unless these conditions were satisfied because we are a long-term business doing long-term projects and we need the framework in which we can make this sort of investment decision.” Quoted in “Oil Groups Snub US on Iraq Deals,” The Financial Times, July 24, 2003. Additionally, US Energy Secretary Samuel Bodman said in July 2006 that US companies are not interested in investing in the country before the security situation improves and a new hydrocarbons law is passed. “News in Brief,” Petroleum Economist, no. 1, 2006, p. 11. For more on alternatives confronting Iraq in rebuilding its oil industry, see a forthcoming book, edited by Robert Springborg, Oil and Democracy in Iraq (New York: Saqi Books, 2007); and Thomas W. Wälde, “The Iraqi Scenario: The Impact of Fundamental Regime Change in Iraq on Acquired and New Contractual Titles in Iraq Oil Industry” Oil, Gas, and Energy Law, vol. 1, no 1, January 2003.
Western service companies, such as Halliburton and Schlumberger, under IOC control. On the other hand, the hybrids should agree to higher gasoline taxes, and stricter and broader Corporate Average Fuel Economy (CAFÉ) standards. While this would open the door for future reduction in oil demand and reduced carbon emissions, something Western IOCs do not necessarily support, it would also give them a ‘fair’ standing against the NOCs, and reduce or eliminate competition from Western service companies.

Thus, in order to improve their IOCs’ bargaining power vis-à-vis oil exporting and oil-importing governments and their NOCs; to expand their IOCs’ upstream operations; to insulate their countries from military and political pressures of other governments; and to maintain the strength of the oil industry; Western governments should increase their intervention in the oil industry. Lukoil, a private Russian oil company, which has always acted in close coordination with the government, often presenting itself as a faithful servant of state, “could become a model for international majors seeking to redefine themselves and their roles in the new global landscape where state oil companies are gaining precedence over private ones.”

In 1981, Øystein Noreng argued that French, Italian, Norwegian and British NOCs, unlike IOCs, were operating under a raison d’être that largely carried them above market forces, as they were able to mobilise funding in the event of mistaken judgment. In addition, these NOCs were not subject to the same set of sanctions as are IOCs, since if the latter erred in judgment by expanding too fast or misusing funds, they were punished by the market, and hence they have had to reduce their rate of growth or, in extreme situations, declare bankruptcy. As a result, at the time, Western NOCs could permit themselves greater risks and higher rates of growth than IOCs, thus paying less attention to the most efficient use of resources and capital in deference to other goals. Noreng’s suggestions support my suggestion that Western governments should seriously consider intervention and possibly ownership as a way forward in their oil industries. The bottom-line is that market forces and private enterprise do not appear to be the appropriate instruments for solving oil industry problems, which are of prime national importance. Establishing NOCs, or at least hybrids, could help in alleviating these problems.

If the Western IOCs do not get more closely controlled by their home governments, their way to survive in the long-term, and to remain internationally competitive in the short-term, would be to continue with mergers and industry consolidation. However, mergers are often associated with firms in a declining, mature industry, and are defensive, short-term measures. Mergers would make the industry more concentrated, and we could witness a return to the days of Standard Oil Trust, particularly since antitrust regulators in the second Bush administration

1122 Gorst, “Lukoil: Russia’s Largest Oil Company,” p. 2. Lukoil is the only Russian oil company to have built up a diversified business empire that now spans the globe, and selection of foreign assets has been in part driven by state interests. The company has interests in the Caspian, Middle East, Central Europe, North Africa, North and South America. This unique international portfolio allows Lukoil to serve as an oil ambassador for the Russian government overseas. Unlike that of major IOCs, in recent years, Lukoil’s oil reserves steadily increased. See Gorst, “Lukoil: Russia’s Largest Oil Company.”


have given the green light and have favoured large-scale oil industry mergers. Booking additional reserves will remain a major problem encountered by the Big Oil, and upstream mergers, as in the 1990s, would be the major way to tackle this problem.\footnote{For U.S. oil industry merger trends and effects see United States General Accounting Office, “Energy Markets: Effects of Mergers and Market Concentration in the U.S. Petroleum Industry,” Report to the Ranking Minority Member, Permanent Subcommittee on Investigations, Committee on Governmental Affairs, U.S. Senate, May 2004.} In the short-run, larger units would be capable of competing globally, since “the bigger the player, the more likely it is to get a helping hand when contract negotiations get tough.”\footnote{Stephen Glain, “The Next Big Deal,” \textit{Newsweek}, Special Edition, December 2006-February 2007, p. 51.}

Alternatively, if they do not merge, or if they do not get increasingly controlled by their home governments, the Big Oil companies might ‘atomise’ and turn into a number of ‘niche’ non-integrated companies, which would concentrate on specific products or pieces of the value chain, similar to what several service companies already practice.\footnote{Philip K. Verleger Jr. suggested that if the IOCs were car companies, their future would probably look something like that of Mercedes: a famous label holding its own in a high-end but small niche. See Verleger, “The Mercedes Model,” \textit{Newsweek}, Special Edition, December 2006-February 2007, p. 39.} If this were the case, IOCs would act as service subcontractors to NOCs.\footnote{Myers Jaffe and Soligo, “IOCs: Investment and Industry Structure,” p. 11.} By focusing on fewer aspects of the oil business, they would have a less complex balance of costs and risks to manage. However, whether they continue with mergers, or become niche companies, IOCs are most certainly going to play a diminished role in future.

Entry into alternative energy may be a possible way forward for major IOCs. Driven by the pressure to replace reserves, many of the major IOCs, except for Exxon Mobil, have begun shifting their businesses in response to the changing landscape and hostility of numerous host states. Royal Dutch/Shell’s expensive and challenging Sakhalin gas project; Shell’s and Chevron’s multibillion-dollar investments in Canada’s oil and tar sands;\footnote{See “Shell in Canadian Oil Sands Deal,” \textit{BBC News}, May 8, 2006, \url{http://news.bbc.co.uk/go/pr/fr/-/hi/business/4751357.stm}, [May 9, 2006]; and “Lure of the Sands,” \textit{Petroleum Economist}, June 2006.} BP’s entry into solar power and hydrogen projects; Chevron’s purchase of UNOCAL; and many IOCs’ entry into biofuels, are all reflections of IOCs’ desperation as they are investing where they can. These investments are driven by the strong belief that high oil prices are here to stay. However, with today’s technology, biofuels, tar sands, and shale oil are much more expensive to exploit than conventional oil pumped in OPEC and many non-OPEC countries. Oil price at which biodiesel is economically viable is $80 a barrel, for U.S. corn-based ethanol it is $60 a barrel, for shale oil it is $50 a barrel, while for tar sands, Brazilian cane-based ethanol, gas-to-liquids and coal-to-liquids is $40 a barrel.\footnote{“Steady as She Goes,” \textit{The Economist}, April 22, 2006, p. 67. For example, Canada’s Energy Board estimated that to produce a barrel of synthetic crude oil from Canada’s oil sands would cost approximately $39. See National Energy Board, “Canada’s Oil Sands: Opportunities and Challenges to 2015: An Update,” National Energy Board, June 2006.} According to analysts from McKinsey & Company, “dangers await companies that place too large a bet on a fundamental structural change by investing in projects that will be profitable only if the [oil] market has altered for good.” They suggest that major IOCs would do better if they “exercise discipline over capital spending and to invest in opportunities to build sources of competitive advantage that they can sustain regardless of whether prices shift structurally or revert to levels closer to the long-term averages.”\footnote{Richard Dobbs, Nigel Manson, and Scott Nyquist, “Capital Discipline for Big Oil,” \textit{The McKinsey Quarterly}, December 2005.}

If they diversify into alternative energy, they will most likely be unsuccessful, as business history suggests that firms in ‘maturing’ industry do not easily adapt to new substitutes.\footnote{Myers Jaffe and Soligo, “IOCs: Investment and Industry Structure,” p. 11.} Moreover,
history of the oil industry is long on boom-and-bust cycles in crude prices and refining margins, and short on examples of capital discipline. During booms, IOCs behave as if the world had changed permanently, investing in projects that could make a profit only if prices stayed high. The industry has wrestled this problem for more than 150 years: in the early 1860s, for example, over-investment in Oil Creek, Pennsylvania, pushed down the price of crude oil from $10 a barrel to 50 cents in less than six months and to 10 cents within a year.1135 Some of the majors, namely BP, Exxon Mobil, and Royal Dutch/Shell, did show capital discipline, as they made strategic investments in assets and technologies, including oil fields and deep-water drilling that demanded specialist capabilities and large amounts of capital.1136 Nowadays, however, major IOCs are unable to make strategic investments in large oil fields, as those are out of their reach due to political circumstances.

By investing in alternative fuels, many major IOCs are actually contributing to the chance of a future bust in oil prices. The longer crude oil prices remain high, the greater the incentive for major IOCs to invest in alternative fuels and technologies, and the more price-competitive these technologies become as a result of scale effects. However, if IOCs’ investment in alternative fuels and technologies increases, the result would be excess capacity and capital loses across the value chain. Increasing demand for alternative fuels would result in weaker oil demand, which would in turn result in much lower oil prices. Cheap oil would certainly be cheaper than alternative fuels, and demand for the latter would decrease, thus making IOCs’ investments in alternative fuels and technologies highly unprofitable in the long-term. This would in turn, result in hard landing for IOCs that invested in alternative energy. If diversification into alternative energy continues at fast pace, Exxon Mobil may be the only major IOC to survive. Rather than spending extra cash on projects that require high oil prices, it is resisting the pressure to invest more. When asked why Exxon Mobil was spending so little on alternative sources of energy, such as ethanol, the new CEO Rex Tillerson, who succeeded Lee Raymond in late 2005, said, “We are investing heavily in conventional oil and natural gas, which is the business we are in. We are not in those other businesses.”1137 It is clear that Exxon Mobil executives are reluctant to empty their coffers for new development, fearing that prices will trend lower in the future and hammer their profit margins. Between 2006 and 2009, unlike many other IOCs, Exxon Mobil is expected to bring online a number of new major projects. Although a number of these projects are located in areas that have peaked in production – Alaska, Gulf of Mexico, the North Sea, and Australia – many are located in potentially lucrative, although not the most attractive areas, such as Nigeria, Angola, Azerbaijan, Kazakhstan and Qatar.1138

NOCs and their Home Governments

NOCs are the most dynamic force shaping the future direction of the oil industry. They are competing with IOCs in bidding and bargaining for projects and investment opportunities, long the preserves of the majors. Companies from China, India, Russia, Malaysia and Brazil have won concessions to explore for and develop petroleum resources overseas, and some analysts have been quick to identify the ‘new Seven Sisters’.1139 In today’s high oil price environment, NOCs have also been able to leverage their influence to an extent not seen in recent years. As Big Oil scrambles to book more reserves in order to convince investors that they have room to grow,  

1135 See Yergin, The Prize.
1136 Dobbs, Manson, and Nyquist, “Capital Discipline for Big Oil.”
1138 See illustration in ibid, p. 56.
NOCs that control access to those reserves have bigger bargaining chips at the negotiating table. Meanwhile, NOCs are able to compete with IOCs in everything, from field development, to mergers and acquisitions. Although not the focus of this study, Saudi Aramco has silenced many sceptics by significantly boosting the kingdom’s output without the help of foreign partners. Chinese NOCs are steadily increasing their share of the world’s oil resources and expanding their range of oil-industry functions - from exploration, to refining, to distribution. In 2005, CNOOC was a serious contender to buy UNOCAL, and although it lost to Chevron due to U.S. government’s interference, in future, acquisitions of medium-sized independents in geographic proximity to their Asian operations remain likely for China’s NOCs. Overall, NOCs will most likely attempt further acquisitions on the scale of the UNOCAL bid, as they need to establish a strong international upstream platform to compete with IOCs.

Perhaps NOCs’ greatest asset is their unique long-term perspective. Since NOCs, as instruments of the state, have assured access to their countries’ reserves and do not have to think of the next financial quarter, they have the luxury to think strategically. Thus, unlike many IOCs, they have the time to implement their strategy. Internationally NOCs, just like IOCs, face problems with maintaining market share and establishing new markets, increasing competition, protecting future demand for hydrocarbons and responding to new environmental regulations in the consuming countries. These external challenges, however, are not high on the radar for most NOCs, and overseas expansion is much more a luxury than a necessity, with the exception of NOCs from net oil-importing countries such as China and India. Challenges in domestic upstream activities are the greatest concern for oil-exporting NOCs, as they are engaged in a constant drive to improve their managerial skills, technology and capital availability, so they can reduce the reliance on foreign companies and investors.

NOCs enjoy a number of additional advantages over Western IOCs. They are, for instance, able to operate in more politically sensitive environments. Security threats and political pressures that might preclude Western oil companies from investing in certain countries do not necessarily deter NOCs. Similarly, while IOCs are obliged to adhere to the standards of corporate social responsibility (CSR) set by their shareholders, NOCs are less subject to such pressures. For example, political pressure forced Canada’s Talisman Energy to sell its assets in Sudan in 2003 to India’s Oil & Natural Gas Corporation. In addition, Beijing has improved access for its energy companies to overseas upstream projects by entering, in parallel, government-level trade agreements and by offering other governments financial support. In 2005, as part of a government-to-government package of financial and political co-operation, Sinopec signed a memorandum of understanding with Indonesia’s Pertamina to build a $2.5bn refinery in East Java. In exchange for this downstream investment, Sinopec expected access to upstream hydrocarbons reserves, and this illustrates how China’s government is driving its energy firms to success. Hence, NOCs and their respective governments are likely to exploit their advantage over Western IOCs in order to pave way to oil industry domination.

The future looks bright for non-Western oil exporters and their NOCs as long as Western governments continue ‘business as usual’ approach to ‘their’ IOCs. NOCs are likely to become even more dominant in the upstream sector as oil production dwindles in areas which are open to all comers, such as the North Sea and the Gulf of Mexico. ‘New’ oil is most likely to be found in NOCs’ territory, precisely because it is largely out of bounds to multinationals, and so has not yet been thoroughly raked over. In the future, therefore, oil production will be even more concentrated in the hands of the national firms of Russia and the Middle East. Domestic challenges, such as technological and managerial backwardness, and the lack of capital needed to

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1140 “Unocal: A Bump in the Road.”
1141 “Oil’s Dark Secret,” The Economist, August 12, 2006, p. 56.
develop existing and new fields, can be obtained from other NOCs, both from oil exporting countries (Sonatrach, Saudi Aramco, Petronas, Petrobras, Statoil, etc.) or oil importing countries (CNOOC, Sinopec, CNPC, etc.). NOCs are also banding together to help develop each other’s reserves, leaving the oil industry growth in their own hands. Moreover, technological and managerial assistance, and capital can also be obtained from independent oil companies, service companies, or financial and consultancy firms. International players are highly unlikely to penetrate their national markets, as barriers to entry are very high. The doors are likely to remain closed for IOC penetration of their domestic markets as long as the oil prices remain high and there is a wide variety of actors competing with IOCs. IOCs are also unlikely to improve their upstream positions, as they seem unlikely to emerge victorious in their outright competition with NOCs. This is particularly so since NOCs are not compelled to vertically integrate in order to reduce their operational imbalances by gaining overseas downstream positions at all cost. By controlling the majority of world’s upstream activities, and having de facto monopoly in domestic downstream activities, they already generate much economic rent.\textsuperscript{1142}

By increasing competition in oil-importing countries, NOCs’ downstream expansion would, besides putting them in a more direct relationship with end-user markets, also reduce IOCs’ already low downstream economic rent. In addition, according to Luciani and Salustri, NOCs should vertically integrate because of their increasing control over crude prices. They would be able to increase their control of the crude prices, as they would be able to bypass the crude market and sell directly into the products market, and thus reduce their dependence on the whimsical movements of a small number of highly unrepresentative benchmark crudes (Brent and WTI) that dominate term-contract pricing.\textsuperscript{1143} Majid Al-Moneef is also supportive of this proposition, arguing that vertical integration would help NOCs balance their operation and protect them from the inherent instability of the market, so when crude prices are low, refining and marketing margins can generally be expected to be positive. A further benefit of vertical integration for oil exporting NOCs would be the potential to secure market share and ensure its future growth.\textsuperscript{1144}

Overall, the most logical cause of action for oil-exporting governments and their NOCs would be to exercise the following strategy. Even more emphasis should be placed on their already close relationships and partnerships with other ideologically close and neutral countries and their NOCs. This should be done with the goal of signing additional government-to-government long-term contracts with destination clauses (rather than relying on spot and futures markets), purchasing smaller private oil companies, improving technological and managerial skills, efficiency and attracting capital. Additionally, in order to improve their understanding of, and proximity to, the market; reduce their dependence on IOCs for market access; correct their operational imbalances; and successfully compete with IOCs, NOCs should attempt to increase their international upstream, transport, refining and retail facilities, both in Western and particularly non-Western (mainly Asian) countries. In order to respond to the challenge of global industry trends, such as possible future IOC mergers, NOCs may need to expand internationally and integrate their activities. As for those NOCs that are engaged in partnerships with IOCs, they should absorb as much knowledge as possible from IOCs, and should make knowledge

\textsuperscript{1142} Traditionally, vertical integration has been the strategy preferred by oil companies serving large markets, to secure oil supplies and capture a larger part of the economic rent. See Luciani and Salustri, “Vertical Integration as a Strategy for Oil Security;” and Giacomo Luciani, “The Dynamics of Reintegration in the International Petroleum Industry,” in Kate Gillespie and Clement Moore Henry (eds.), Oil in the New World Order (Gainesville: University Press of Florida, 1995).


\textsuperscript{1144} For more, see Majid A. Al-Moneef, “International Downstream Integration of National Oil Companies,” in Paul Stevens (ed.), Strategic Positioning in the Oil Industry: Trends and Options (Abu Dhabi: The Emirates Center for Strategic Studies and Research, 1998), pp. 45-60.
transfer as one of the agreement requirements following the example of Iran and its ‘buyback’ agreements.

A mutually beneficial scenario could be pursued between Asian oil-importing NOCs and oil-exporting NOCs from the Middle East, Russia, Africa and Latin America.\textsuperscript{1145} Asian importing countries are highly dependent on crude imports from all of these regions, and as a result, many Asian governments support their NOCs’ efforts to secure new sources of supply. There have been some indications of this development, as in December 2006, China announced that it wants to start direct negotiations and establish formal ties with OPEC to secure a stable oil supply and an equitable share of the oil market.\textsuperscript{1146} In a parallel move, oil-exporting NOCs have tried to gain entry to Asia’s downstream markets, primarily in China and India, in order to secure outlets for their crude oil exports and to ensure security of demand. This interpenetration of upstream and downstream assets makes for a natural fit between importing countries concerned about security of supply and declining reserves, and exporting countries preoccupied with security of demand and seeking to expand their markets. Besides building close ties to oil exporting states and helping its NOCs in overseas bargaining situations, non-Western oil importing countries such as China and India should continue diversifying the sources of their oil. They should also intensify domestic oil exploration and production, establish strategic petroleum reserves, and increase energy efficiency and conservation, possibly through higher taxation, since they are currently at very low levels. Moreover, they should diversify their reliance on oil toward nuclear power, natural gas and other energy sources, the supply of which is less susceptible to sea-lane interdiction. Finally, they should centralise their energy agencies; reduce reliance on IOCs for oil transportation; and develop the military capability to protect their oil supplies.

Adopting such strategies would most likely reduce their vulnerability to international pressure concerning oil, and China already engaged some of these options. Besides being relatively successful in diversifying its sources of imported oil, in 2006 China began to store emergency supplies of oil in ‘strategic reserves’.\textsuperscript{1147} In addition, the creation of a powerful new agency tasked with safeguarding China’s energy security may be the right step towards centralised decision-making. This agency, provisionally called the State Energy Office (SEO), was inaugurated in May 2005, and it replaced a small Energy Bureau that had been working inside the National Development and Reform Commission (NDRC). In future, SEO will report directly to the State Council, and this will in turn help in creating a coherent energy security strategy for China.\textsuperscript{1148}

Many observers argue that NOCs should be privatised and that their governments and societies would benefit most from such a step. This view is heard in the halls of the World Bank and the IMF and is expressed by a number of IOC executives and government officials in the importing countries, as well as by Western media and consultants.\textsuperscript{1149} However, this cause of action would

\textsuperscript{1145} Keiichi Yokobori, “Strategic Options and Opportunities for Gulf Oil Companies in the Asian Markets,” in Paul Stevens (ed.), \textit{Strategic Positioning in the Oil Industry: Trends and Options} (Abu Dhabi: The Emirates Center for Strategic Studies and Research, 1998), pp. 61-79, explores such possibilities for Middle Eastern oil companies in East Asia.


\textsuperscript{1148} Goldstein and Kozyrev, “China, Japan, and the Scramble for Siberia,” p. 166. I believe that this is a very important step, as according to Philip Andrews-Speed, for China, the threat from ineffective energy industry governance is probably as great as that from the international energy market. See Andrews-Speed, \textit{Energy Policy and Regulation in the People’s Republic of China} (The Hague: Kluwer Law International, 2004).

not be in the interest of their governments. NOCs serve state interests more directly than do private companies because they are instruments of the state. If they become private actors, just like IOCs, they would become distant from the governments, and their interests would often be conflictual rather than harmonious. In addition, there is no reason why their national status should prevent any of these companies from being highly competent and efficient. They can strive to excel within the NOC model by developing NOC and company-specific strengths. Their strengths come from their relationship with, and support from, their government and society. The state’s assets are strengths of NOCs because they usually enjoy exclusive rights on the home territory. Besides natural resources, these assets include the government’s network of alliances and relations with other countries and their NOCs. These features are absent from IOCs’ relationship with their home governments, and this is likely to be detrimental for IOCs’ future.

8.3 Heuristic Value for Further Research

This study carries much heuristic value for further research. Firstly, the same approach could be applied to studying different oil industry bargaining scenarios. For example, studying oil industry bargaining in Iraq, Saudi Arabia, Nigeria, Canada or Kazakhstan promises to be very interesting, and makes one wonder whether the same set of conclusions would be reached. A hypothetical study could also be attempted in order to study oil industry bargaining under the condition of ‘peak oil’, or at times of low oil prices, since this study was focused on studying oil industry bargaining under tight market conditions. One could assume the balance of bargaining power to change significantly under different conditions. Moreover, instead of studying exclusively oil scenarios, one could engage in studying scenarios involving bargaining over natural gas, another energy source, such as coal or uranium, or other extractive minerals, such as copper or nickel. One could also assess whether other countries, such as India and Japan’s, NOCs are also gaining bargaining power at IOCs’ expense. Finally, one could study how much international norms and the international law constrain various oil industry actors’ bargaining behaviour. For example, are host governments, NOCs, or IOCs constrained by international norms and law in their behaviour vis-à-vis other actors? Historically, IOCs have been accused of complicity in human rights violations, of supporting undesirable political regimes, and of indifference to the environmental impacts of their operations. This study found that oil importing countries’ NOCs act in exactly the same manner, and that at times of high oil prices host governments tend to disregard previously signed contracts and unilaterally act to annul their validity.

Various findings and conclusions from this study warrant further investigation. The framework developed to measure bargaining power of IOCs vis-à-vis host governments requires further scrutiny and application. Are there any variables that should have been included or excluded? Should variables carry different weight when compared to each other? For example, do oil prices matter more than availability of local allies in determining IOCs’ relative bargaining power? Do political or economic factors matter more in determining bargaining outcomes? Furthermore, the link between home state and IOC interests, home state support for IOCs, and any influence that this support may have on IOCs’ bargaining outcome vis-à-vis other actors, warrants further investigation, since this study found mixed results. Similarly, since I found that when a major oil-importing government’s oil supply security is perceived as threatened when bargaining with other


actors then this government would not necessarily emerge victorious from bargaining, one could examine under what conditions are oil-importing governments successful in bargaining with other actors. In addition, other bargaining scenarios could be examined in order to confirm whether, when oil-exporting states use oil, explicitly or tacitly, they gain concessions in bargaining with other actors. Finally, I found that exit and voice potential of IOCs is low as compared to the overall trend, as the IOCs have lost their influence over host states in this decade. A question that warrants further research is whether oil is the exception, and whether other industries witness similar development as opposed to common perceptions (see Figure 8.1).

Figure 8.1: Possible Matrix of Host Governments’ Exit and Voice Potential from Global Economic System

Conclusion

After discussing the main findings in Chapter 7, in this chapter, I firstly outlined various reasons why this dissertation offers an original contribution to knowledge. Secondly, based on my findings, I proposed policy implications for major actors in the oil industry – IOCs, their oil-importing home governments, and NOCs and their oil-importing and oil-exporting owners. While this section was clearly not the primary objective of this study, it was written with a belief that it may or may not eventually influence policy. Finally, I proposed various directions for future research.
APPENDICES

APPENDIX 1: Selection of the IOC-Host State Bargaining Model Variables

From a review of the relevant literature, numerous host country/industry context factors and IOC-specific resources have been identified (see Figure 2.3). Overall, there are nineteen variables. While eleven of these variables are drawn from general oil industry and each particular host country context, four are IOCs-specific resources, and four are relative variables, where score reflects relative assets of IOCs vis-à-vis host states (for methodology on determining the score, and all the scores, please refer to Appendix 8).

Industry and Country Context

1) Reserve Size

Since the host governments have ultimate sovereignty, the more dependent the IOCs on their oil, the more powerful the government’s bargaining position. According to Greg Muttitt, countries that control large reserves possess more bargaining power against the IOCs than those in possession of smaller reserves, and the latter generally accept a lower share of revenues than those more attractive to IOCs. Toby Shelley supports this hypothesis, and argues that those countries, which yet have to demonstrate that they have commercial reserves and those that have small reserves, such as Yemen, Angola and Mauritania would usually get a smaller take from contracts with the IOCs. There will clearly be more interest among the IOCs for investing in countries like Saudi Arabia, Iran, Iraq, Kuwait, UAE, Venezuela or Russia, rather than Indonesia, Malaysia or Egypt. For example, Jeroen van der Veer, chief executive of Royal Dutch/Shell said, “One has to realise that with Iran, when you look at both oil and gas reserves, they have a very strong position as a country.” If IOCs show more interest, this indicates that they place high value on establishing their presence in that particular host country, which can therefore exploit its natural endowment at the expense of IOCs.

2) Reserve Longevity

Governments in control of oil reserves, which at current production are expected to last longer, are expected to have higher bargaining power vis-à-vis the IOCs, than those governments whose reserves, at current production rates, are expected to last for a shorter period of time. Thus, other things equal, countries with higher R/P ratios are expected to exert more bargaining power against the IOCs as compared to countries with lower R/P ratios.

3) Potential Profitability

Potential oil production profitability influences bargaining power of IOCs against host countries. This assumption is self-explanatory, as it is obvious that, while excluding all other variables, there will be more interest among the IOCs for investing in countries where production would yield

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1152 Muttitt, “Production Sharing Agreements: Oil Privatisation by Another Name?”
1154 Quoted in Sally Jones, Dow Jones Newswires, April 25, 2006.
high profits, such as in Saudi Arabia, Iran, Iraq, Kuwait, UAE, Venezuela or Russia, rather than in Canada or Mexico. Higher the potential for profitability, higher the IOCs’ interest in establishing their presence, and therefore, higher the bargaining power the host country possesses against the IOCs.

4) Level of Economic Development

The level of economic development of a host country can have an impact on MNC’s bargaining power vis-à-vis the government of that country. A host country’s “absorptive capacity,” referring to the capacity of its local firms and government agencies “to recognise the value of new external information, assimilate it, and apply it to commercial ends,” is directly reflective of its level of economic development. Therefore, a host country, which is at the high stage of economic development, will be associated with high bargaining power. Conversely, for countries that are at lower levels of economic development an MNC would exercise greater bargaining power.

5) Barriers to Entry

Barriers to entry to a particular country’s oil industry affect bargaining power of IOCs. If barriers to entry are low and it is easy to establish IOC presence in a particular host country, an IOC would possess high level of bargaining power vis-à-vis the host government. This is so because lower entry barriers indicate that any given host country needs IOC presence in its oil industry and low barriers serve as an invitation to IOCs.

6) Strategic Importance of the Industry

MNCs operating in industries, which are of strategic importance to a host country, are expected to be in relatively weak bargaining position. Poynter found that MNCs operating in high importance industries (including cement, steel, oil refineries, infrastructure and natural resources) were strongly associated with higher intervention levels than MNCs operating in the other industries.

7) Cultural/Political Context

Moreover, IOCs’ bargaining power can evaporate with domestic political changes in host countries. For example, host nations, which contain ruling politicians, noted for their leftist, socialist, nationalist, or anti-Western and/or anti-capitalist stance will almost always tend to obtain greater rewards from intervening in subsidiaries, which epitomise the ideological opposite. Additionally, when dealings between the government and companies are widely publicised in the press and other media, the government tends to have a bargaining advantage, since IOCs are often portrayed as foreign interlopers, so the government can utilise public opinion to sway negotiations toward more favourable outcomes.

1157 Poynter, “Government Intervention in Less Developed Countries: The Experiences of Multinational Companies,” p. 18; and Poynter, Multinational Enterprises & Government Intervention, pp. 51-2. A similar result was found by Bradley, “Managing against Expropriation.”
1158 Poynter, Multinational Enterprises & Government Intervention, pp. 63-4.
1159 See Grosse, Multinationals in Latin America, p. 83.
8) Competition

Traditional industrial organisation economists have suggested that an industry’s level of profitability should decrease as its concentration level (the degree to which a few large sellers dominate an industry in terms of relative market share) decreases.\(^{1160}\) Intense industry competition, or low industry concentration, has been viewed as reducing the bargaining power of an MNC operating in the industry,\(^{1161}\) as firms have to battle more fiercely against each other for such things as customer support, the best inputs, or the latest technology. The result of these battles is heightened environmental uncertainty for individual firms.\(^{1162}\) Robert Grosse argues that the power of government is greater in highly competitive industries, where more than two or three MNCs are able to supply the product or service. In this situation, the government may be able to play the firms against each other to obtain the outcome most favourable to the country.\(^{1163}\) This is also supported by Raymond Vernon, who argues that wherever rival sources of capital, technology or access to markets have appeared, “their rivalry has diluted the unique strengths of any single enterprise and has weakened its bargaining position.”\(^{1164}\)

In services, capital, technology or access to markets they offer, besides competing with each other, IOCs nowadays face a lot of competition from service companies, such as Halliburton or Schlumberger; developing world NOCs, as we are witnessing “an increased blurring of NOC-IOC categories”\(^{1165}\), independents; local private oil companies; and/or specialised energy consultancy firms. Competition that the IOCs face has increased considerably in the past decade, especially with the rise of oil importing countries’ NOCs.

With high-profile international ventures, NOCs such as Sonatrach of Algeria, KPC of Kuwait, Saudi Aramco, Petronas of Malaysia, Petrobras of Brazil, Sinopec, CNPC and CNOOC of China, Pemex of Mexico, PdVSA of Venezuela, Statoil of Norway, and Gazprom of Russia, are challenging the IOCs on their territory of high political risk ventures. Many are implementing a dedicated internationalisation strategy, and it is becoming difficult to confine 'national oil companies' to their national borders.\(^{1166}\) While many host governments of these companies started with little skills base, an uneducated workforce, many of them have since expanded their core business to integrate their activities through the value chain and are not embarking on internationalisation strategies where they strive to be as competitive as the IOCs.\(^{1167}\) Saudi Aramco, the top NOC source for best management practices, advanced technology and expertise, rivalling that of major IOCs, enabled Chinese NOCs to improve their exploration and production. Petrobras is tackling exploration in the deep and the ultra-deep acreage with technology that had previously been the reserve of the IOCs, and the Chinese NOCs are


\(^{1163}\) Grosse, Multinationals in Latin America, p. 84.

\(^{1164}\) Vernon, Storm over the Multinationals, p. 194.


\(^{1166}\) Ibid.

\(^{1167}\) Ibid, p. 4.
especially competitive, because they develop cheap and effective technical solutions. Note however, that the transfer of advanced technology from the United States is effectively barred under regulations governing the export of dual use and other strategically sensitive items.

Additionally, service, or ‘niche’ companies such as Schlumberger and Halliburton can provide services often at a better cost than IOCs. They offer a wide range of services, related to exploration, seismic, drilling, transportation, and so forth, and this therefore increases friction with IOCs. In addition, service companies are able to step in to countries with high entry barriers to the IOCs, as they, unlike IOCs, which usually engage in large integrated projects, operate under strict and very limited parameters, and unlike the IOCs, prefer fee-for-service agreements, which are also preferred by many host countries. Moreover, by offering financial management tools (hedging, futures), technical consulting, systems consulting, management skills consulting and access to capital, IOCs clash with other service providers, such as banks and specialised consulting groups who already offer these services and may often be preferred by host governments.

9) World Oil Market Prices

World oil prices affect bargaining power of IOCs vis-à-vis the host governments. If the oil prices are low, host governments are usually needy of foreign capital investment in their oil industry. Therefore, their bargaining power against the IOCs is negatively affected. Alternatively, if the oil prices are high, host governments are endowed with a lot of capital and will not be needy of foreign investment, and thus, their bargaining power vis-à-vis the IOCs will be higher.

10) Level of Political and Economic Risk

Finally, a particular country’s level of political and economic risk and/or stability affects its bargaining power vis-à-vis the MNCs. For example, if the country’s credit ratings, published regularly by Moody’s, Standard & Poor’s and Fitch, are favourable, and the credit risk is low, excluding all other variables, that particular country would have bargaining advantage vis-à-vis the MNCs. If the political and economic risk were high, the host government would have lower bargaining power against the MNCs.

11) Oil Scarcity Perception

Other things being equal, the bargaining power of host countries vis-à-vis MNCs is stronger when minerals are perceived as scarce, and weaker if they are perceived as abundant. Thus, if there is a general perception of oil scarcity, host states and their NOCs are expected to exert higher bargaining power than the IOCs. Alternatively, if there is a general perception of

1168 Marcel, Oil Titans, p. 209 and 219.
1170 NIOC manager quoted in ibid. p. 7.
1173 Marcel, Oil Titans, p. 214.
1174 While rising oil prices helped Venezuela in their bargaining with IOCs, they did not help Canada. See Tugwell, The Politics of Oil in Venezuela; and Jenkins, “Reexamining the ‘Obsolescing Bargain’”, pp. 159-60.
1176 McKern, Multinational Enterprise and Natural Resources, p. 23.
abundance of oil, the IOCs are expected to exert higher bargaining power vis-à-vis host states and their NOCs.

**IOC Specific Resources**

1) **Reputation**

Firm reputation may be an important source of an MNC’s bargaining power. Economists and strategy scholars have long recognised the strategic importance of “invisible assets” such as corporate reputation, image, and brand name. Positive corporate reputation may enhance an MNC’s bargaining power, as positive reputations can convey a signal about an MNC’s “socio-political legitimacy” in dealing with various publics (including the host government). In turn, the host government may use high-reputation MNCs already operating in the host country as a signal to the international investment community that it provides an attractive climate for FDI. Thus, an MNC that has a good international reputation may command greater bargaining power insofar as it can leverage its social network ties with other MNCs operating in the host country and achieve favourable terms in its negotiations with the host government.

2) **Availability of Local Allies**

Local allies can be a potent source of bargaining and lobbying power for IOCs vis-à-vis the host government. Barbara Jenkins’ 1986 study of the National Energy Policy (NEP) implemented in Canada in October 1980, found that the American IOCs were able to defeat the NEP by using local allies.

3) **Availability of Alternative Options**

An MNC’s ability to substitute for host country resources and related, high levels of competition among countries for investment, improves its bargaining power vis-à-vis a host country. For example, if an IOC is engaged in renegotiation with a host government, and if it has equally or more profitable options to pursue elsewhere, this positively affects its bargaining power against the host state. Barbara Jenkins’ 1986 study of the National Energy Policy (NEP) implemented in Canada in October 1980, found that the American IOCs were able to defeat the NEP by shifting their oilrigs outside of Canada and cancelling new investments.

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4) Reserve Replacement

Major IOCs’ reserve replacement is an important indicator of their bargaining power. In the oil industry, “reserve replacement is the best guide to whether a company will be able to maintain – or grow – production in the future.” Thus, if IOCs do not manage to replace all of their production in any given year this negatively affects their bargaining power vis-à-vis host states. Alternatively, if they replace all the oil they produce in that year, and manage to get hold of additional reserves, this positively affects their bargaining power against the host states and their NOCs.

Relative Variables

1) Capital Possession

Financial resources and capital in MNC’s possession increase the bargaining power of an MNC vis-à-vis a host government. Producers need investment capital when their fiscal relationship with the state is structured in such a way that their capital needs are sacrificed to government budgetary needs or that their means of revenue generation cannot meet investment requirements. Cash-rich IOCs seem like a perfect choice for host governments needy of foreign investment, and balance-of-payments difficulties or severe external debt problems may increase a host country’s demand for FDI, or limit its freedom of action because of conditions imposed by international financial organisations or commercial banks. Dependence of the economy on FDI may constrain a host country, either because of the control current investors exercise or the fear of repelling future investors. These factors carry a negative influence on host country’s bargaining power vis-à-vis MNCs. However, if host governments do not have severe debt problems and capital difficulties, they may not be in dire need of FDI, and thus may possess higher bargaining power vis-à-vis the IOCs.

2) Technological Know-How

Developing countries seek FDI to access the technology of MNCs. The level of technology an MNC possesses has often been hypothesised to increase the MNC’s bargaining power, ceteris paribus. The main rationale has been that a high level of technological and managerial complexity makes the MNC a more difficult target for host governments to intervene or expropriate since host governments of developing countries often lack the technological competence or knowledge to run MNC’s operation independently. When an MNC’s bargaining power (vis-à-vis host government) is founded on technological “know-how”, it is likely to provide durable basis for generating and appropriating economic rents. If a host government over the years absorbs the technology through learning/imitation or even

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1185 Schwartz, “A Shell of Itself.”
expropriation/nationalisation of foreign operations, we would be witnessing an “obsolescing bargain.” Thus, local technological expertise can influence bargaining power of IOCs relative to that of the host governments. If local technological knowledge is higher than that of the IOCs, the host government would not need the latter, and their bargaining power would be extremely weak. Alternatively, if IOC technological expertise were higher than that of the host government, then the IOC would have higher bargaining power opposed to the host government. It is important to consider technological expertise of the IOCs and host governments in comparative perspective. If it were at relatively similar levels, it would not endow any particular actor with extra bargaining power.

3) Managerial Skills

Managerial expertise may be a potent source of an MNC’s bargaining power that yields sustainable economic rents. Poynter identified operational and managerial complexity as a key determinant of an MNC’s bargaining power, as MNCs characterised by a more sophisticated configuration of technical, operational and managerial systems would have greater bargaining power relative to the host governments.

4) Access to Markets

Access to markets is a MNC power resource. If all other variables are excluded, the ability to export and market access provides IOCs with bargaining power advantage over the host states. However, host states might have considerable access to oil-importing countries’ markets through their NOCs’ operations, and if this were the case, the IOCs’ bargaining power vis-à-vis host governments would be reduced.

Variables not Included

1) Host State’s International Institution Membership

According to Lorraine Eden, the role of multilateral rules negotiated in international institutions of which host countries are members could limit bargaining power of host states, since most governments are members of multilateral organisations. Related, Rami Ramamurti argues that government-to-government bargains can establish overall rules of the game, which then constrain MNC-host state bargaining in specific issue areas. Following, Eden suggested that the web of agreements is creating an investment regime that offers more protection, and bargaining power, to multinationals. Thus, if particular host states are members of organisations such as the IMF, World Bank, or the WTO, that would limit their bargaining power vis-à-vis MNCs. For example, it can be suggested that American MNCs were certainly

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1191 Poynter, “Government Intervention in Less Developed Countries: The Experiences of Multinational Companies.”
1192 Kobrin, “Testing the Bargaining Hypothesis,” p. 620; Vernon, Storm over the Multinationals, pp. 171-2; Poynter, Multinational Enterprises & Government Intervention, pp. 60-1; and McKern, Multinational Enterprise and Natural Resources, p. 22.
1194 Ramamurti, “The Obsolescing ‘Bargaining Model’?”
helped by the fact that in the mid and late 1990s, Russia and Venezuela suffered economically and were highly indebted. Since the U.S. has been the main creditor of their debt, one could assume that American MNCs received a degree of indirect help due to this development.\textsuperscript{1196} However, one could argue that if a host country were a member of OPEC, as many of these same host states are, its bargaining power over IOCs would be enhanced. Goals of OPEC need to be considered when assessing such a possibility. OPEC’s 1961 Statute claims that “Due regard shall be given at all times to the interests of the producing nations and to the necessity of securing a steady income to the producing countries.”\textsuperscript{1197} In 1968, OPEC issued a Declarations Statement of Petroleum Policy in Member Countries. This referred to the inalienable right, as expressed by the United Nations, of all countries to exercise permanent sovereignty over their natural resources in the interests of their national development. The Declaration Statement pointed out that this right applied to OPEC Member Countries directly undertaking the exploitation of their own, indigenous exhaustible resources. Cooperation lies at the roots of OPEC’s existence. Indeed, OPEC was founded on the premise of cooperation, with its first Conference of 1960 resolving that: “The principal aim of the Organization shall be the unification of petroleum policies for the Member Countries and the determination of the best means for safeguarding the interests of Member Countries, individually and collectively.”\textsuperscript{1198} Therefore, cooperation with other member states may help a particular OPEC host state to maximise its interests in a bargaining situation with the IOCs. Thus, due to symmetrically opposite effects of different institutions on host states’ bargaining power vis-à-vis MNCs, the overall international institution membership of host states will be disregarded as a variable in determining host states’ bargaining power vis-à-vis the IOCs.

2) IOC’s Home State Support

It makes logical sense that different country origins of MNCs may affect bargaining power differently in a particular host country. This is due to different historical, cultural and political backgrounds. Further, some have argued that MNCs originating from politically and economically more powerful countries have more bargaining power than those originating from weaker countries.\textsuperscript{1199} For example, if this stood in the oil industry, in bargaining with Iran, Russia and Venezuela, IOCs from the United States would possess more bargaining power than the IOCs from the United Kingdom, Spain, Italy or France, as the U.S., the world’s largest power, would be able to endow its IOCs with extra bargaining power vis-à-vis the host governments. However, this simplified formula ignores the historical realities, which show us that due to differing interests, the U.S. government more often does not, than it does offer support to its IOCs in their overseas bargaining ventures. Moreover, in some countries, host governments may target American IOCs in particular, just because they have grievances against anything American.

Bennett and Sharpe argued that MNC’s “power resources are not entirely interchangeable from context to context, or from contest to contest. What serves as a basis for power in one situation

\textsuperscript{1196} Derived from Poynter’s assumption, that home nations can provide host nations with aid, money, military and economic support, or act as a supporter in multilateral organisations such as the World Bank, the United Nations, etc. Poynter, Multinational Enterprises Government Intervention, p. 62.
\textsuperscript{1198} Ibid.
\textsuperscript{1199} Eden and Appel Molot, “Insiders, Outsiders and Host Country Bargains,” p. 383. They argue that the more powerful U.S. government should be able to influence the MNC-host state bargaining process in Canada in a way that the less powerful Japanese government could not.
may be worthless, perhaps even a liability, in another.”\textsuperscript{1200} Therefore, one could regard supposition that power resources are “fungible,” and that the possession of power resources gives one a centralised capacity whenever and wherever one pleases,\textsuperscript{1201} as dangerously misleading. Hence, considering bargaining power of IOCs by not only considering IOC-specific resources, but also industry and country context (introducing scope and domain as I did above – see variable 7) host state’s cultural/political context), proves to be extremely important. In some cases, powerful home states, such as the U.S., even if they support their IOCs in bargaining with host states, they may in fact weaken these IOCs due to a particularly hostile and anti-American political and cultural context.

\begin{footnotesize}
\begin{enumerate}
\item \textsuperscript{1201} The phrase is from Talcott Parsons, whose suggestion that power be seen on the analogy of money leads to the erroneous supposition of the fungibility of power. See Talcott Parsons, “One the Concept of Political Power,” in \textit{Sociological Theory and Modern Society} (New York: Free Press, 1967). For a corrective, see Baldwin, “Money and Power.”
\end{enumerate}
\end{footnotesize}
## APPENDIX 2: Timeline of Russia’s Domestic Oil Bargaining

<table>
<thead>
<tr>
<th>Date</th>
<th>Event</th>
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<tbody>
<tr>
<td>December 1995</td>
<td>The Duma passed a law on production-sharing agreements</td>
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<tr>
<td>1996</td>
<td>“Loans for shares” scheme; the oligarchs became owners of some of Russia’s most attractive assets, and big political actors in their own right</td>
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<tr>
<td>June 1996</td>
<td>The legislation on production sharing agreements was entered into force, and it discussed license holders negotiating special terms without reference to whether they were Russian or foreign</td>
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<tr>
<td>February 1999</td>
<td>An improvement in legislation, which made PSAs the most attractive form of foreign investment in the Russian oil and gas industry</td>
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<tr>
<td>2000</td>
<td>Vladimir Putin came to power in March; very soon he declared a change in the rules of the game, where oligarchs were no longer able to count on “special access” to the Kremlin as during Yeltsin’s rule</td>
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<td>July 2000</td>
<td>Putin told the oligarchs that he would not interfere with their businesses or re-nationalise their possessions as long as they “stayed out of politics”</td>
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<tr>
<td>Early 2003</td>
<td>The Duma adopted a law which effectively scraps PSAs; under this legislation, oil, gas or other natural resources must be offered, first in open tenders and only then, if no purchasers are found, re-bid on PSA terms; in other words, the government would treat PSAs as a special regime to be applied selectively on a case-by-case basis, and they are likely to be limited to complex and capital-intensive offshore projects</td>
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<td>Mid 2003</td>
<td>The Russian procurator’s office began arresting Yukos executives</td>
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<td>October 2003</td>
<td>Arrest of Yukos CEO Mikhail Khodorkovsky</td>
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<td>January 2004</td>
<td>The Russian government announced that it wanted over $1 billion for a license to explore and develop one of the three Sakhalin-3 parcels, Kirinsky block, the rights to which would be won through a tender process; this decision effectively annulled the results of a 1993 tender, in which Exxon Mobil, Chevron and Rosneft received the same exploration rights</td>
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<td>March 2004</td>
<td>The presidential elections; Putin wins a new term</td>
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<td>April 2004</td>
<td>The Duma passed new oil taxes (export duties) that raised revenues when crude prices were high</td>
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<tr>
<td>August 2004</td>
<td>The new export duties took effect; they work on a sliding scale that hands the state the lion’s share of any gains in the oil price over $25 a barrel</td>
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<tr>
<td>December 2004</td>
<td>Yugansknftegaz, which accounted for 60% of Yukos’s oil production capacity, was sold by the government for $9.35 billion, ostensibly to pay some of Yukos’s huge tax bill (of $21 billion). The sale was to Baikal Finance Group, a hitherto unknown firm, which was three days later bought by Rosneft, a state-owned oil company for an undisclosed sum</td>
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<tr>
<td>February 2005</td>
<td>Russian government’s decision to ban majority foreign participation in new natural resource concessions</td>
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<tr>
<td>April 2005</td>
<td>Russian government presented TNK-BP, the largest foreign oil presence in Russia, with an arbitrary $936 million tax bill</td>
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<td>June 2005</td>
<td>The Kremlin paid $6 billion through Rosneft to increase its stake in Gazprom from 38 to 51 percent</td>
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<tr>
<td>September 2005</td>
<td>72.7 percent of Sibneft bought by Gazprom for $13 billion</td>
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<tr>
<td>May 2006</td>
<td>Russia’s Academy of Natural Science recommended that the state takes majority control of Shell’s, 55 percent owned and $20 billion worth, Sakhalin-2 field, the Kharyaga license held by Total, and Exxon Mobil’s $17 billion Sakhalin-1 field, because they were all behind schedule</td>
</tr>
<tr>
<td>August 2006</td>
<td>Amid skyrocketing oil prices, the Moscow Arbitration Court declared bankruptcy and liquidation of Yukos, assets of which were to be auctioned at well below market rates to Kremlin-controlled companies, Rosneft and Gazprom</td>
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<tr>
<td>September 2006</td>
<td>Russia’s Natural Resources Ministry withdrew its approval of Royal Dutch/Shell’s Sakhalin-2 permit, and revoked the license on environmental protection</td>
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grounds, although the construction work on the development of the field was 75 percent complete, and Gazprom is expected to dominate it in future

<table>
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<tr>
<td>December 2006</td>
<td>Russia suspended vital permits for Sakhalin-2 venture, and it appeared likely that Royal Dutch/Shell will be giving up its controlling stake in the project, and handing Gazprom a significant share</td>
</tr>
<tr>
<td>Late March 2007</td>
<td>Beginning of the auction process in which whatever is left of Yukos, will be acquired by Rosneft and Gazprom</td>
</tr>
</tbody>
</table>
**APPENDIX 3: Timeline of Oil Pipeline Bargaining between Russia, China and Japan**

<table>
<thead>
<tr>
<th>Date</th>
<th>Event</th>
<th>Decision in Favour of</th>
</tr>
</thead>
<tbody>
<tr>
<td>July 2001</td>
<td>President Jiang Zemin signed an agreement in Moscow for a feasibility study of a pipeline from Angarsk to Daqing</td>
<td>China</td>
</tr>
<tr>
<td>July 2002</td>
<td>Feasibility study completed; Yukos to construct the pipeline</td>
<td></td>
</tr>
<tr>
<td>August 2002</td>
<td>State-owned Transneft, whose monopoly on oil export pipelines was threatened by the Yukos project, first raised the idea of a pipeline to Nakhodka</td>
<td></td>
</tr>
<tr>
<td>January 2003</td>
<td>On his visit to Moscow Prime Minister Junichiro Koizumi promised Japanese financial support for the Nakhodka pipeline</td>
<td></td>
</tr>
<tr>
<td>April 2003</td>
<td>Citing that the Angarsk oil reserve was not large enough to sell oil to both China and Japan, then-Russian deputy foreign minister Alexander Losyukov said that Russia had rejected a Japanese proposal to construct a trans-Siberian pipeline to provide Japan with oil, and would instead build a shorter pipeline to Daqing</td>
<td></td>
</tr>
<tr>
<td>May 2003</td>
<td>Yukos’ head, Mikhail Khodorkovsky, signed an agreement with CNPC that seemed to have sealed the Daqing deal with Japan dropped its request for Russian government’s financial guarantees and agreed to contribute $7 billion to help develop the oilfields</td>
<td></td>
</tr>
<tr>
<td>June 2003</td>
<td>Putin said that the Pacific pipeline “looks preferable because it allows broad access to markets”</td>
<td>Japan</td>
</tr>
<tr>
<td>July 2003</td>
<td>Japan dispatched a delegation, led by Iwao Okamoto, director-general of the Natural Resources and Energy Agency, to Moscow; the Japanese energy officials discussed with their Russian counterparts about providing financial and technical assistance to the construction of the Pacific pipeline and the development of oilfields in eastern Siberia; the Japan Bank for International Cooperation was said to be willing to finance the construction project even without any loan guarantees from the Russian government</td>
<td></td>
</tr>
<tr>
<td>September 2003</td>
<td>Kremlin’s assault on Yukos; Russia’s Prime Minister Mikhail Kasyanov’s statement after talks with his Chinese counterpart, Wen Jiabao, in Beijing: “Russia would uphold its commitments to supply oil to China,” by delaying consideration of the pipeline to Daqing for three to four months to “assess the environmental impact.”</td>
<td></td>
</tr>
<tr>
<td>October 2003</td>
<td>Khodorkovsky arrested</td>
<td></td>
</tr>
<tr>
<td>February 2004</td>
<td>Igor Yusufov, then Russian energy minister, hinted that Russia was leaning towards the construction of the Pacific line due to its greater strategic importance to the country; the pipeline was to be built by the state-owned Transneft</td>
<td></td>
</tr>
<tr>
<td>May 2004</td>
<td>The heads of Gazprom and the two oil companies Rosneft and Surgutneftegaz affirmed their commitment to common routes for oil and gas pipelines to Nakhodka</td>
<td></td>
</tr>
<tr>
<td>Date</td>
<td>Event Description</td>
<td></td>
</tr>
<tr>
<td>--------------</td>
<td>---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------</td>
<td></td>
</tr>
<tr>
<td>September 2004</td>
<td>The Russian government officially withdrew its support for Daqing route and instead expressed interest in an even longer and more expensive pipeline from Taishet, and not Angarsk, to Nakhodka, from which oil could be shipped to Japan and other Asian customers</td>
<td></td>
</tr>
<tr>
<td>December 2004</td>
<td>Prime Minister Mikhail Fradkov formally announced the decision to go with Japan.</td>
<td>A mysterious $6 billion transfer from China for future oil deliveries, that were used to help Rosneft, a state-owned oil company, buy Yuganskneftegaz</td>
</tr>
<tr>
<td>April 2005</td>
<td>When the government's instructions to Transneft were released, the schedule for pipeline construction, to be done by the end of 2008, refers only to an initial section from Taishet to Skovorodino in the Amur region – a stone's throw from the Chinese border. With Yukos out of the way, Moscow shifted its attention back to the Daqing route. It announced that the pipeline will head south from Skovorodino first, and that Japanese fears that they would not be prioritised may be realised.</td>
<td>China</td>
</tr>
<tr>
<td>July 2005</td>
<td>Putin said that China would get two-thirds of 600,000 bpd of oil that Russia plans to export to Asia within four years.</td>
<td></td>
</tr>
<tr>
<td>September 2005</td>
<td>Putin said that Russia would first build a pipeline from eastern Siberia to China and then a smaller line to the Pacific coast near Japan.</td>
<td></td>
</tr>
<tr>
<td>Early November 2005</td>
<td>Russian Prime Minister Mikhail Fradkov assured his Chinese counterpart Wen Jiabao that the construction of a key cross-border crude oil pipeline will go ahead as per 2001 agreement.</td>
<td></td>
</tr>
<tr>
<td>Late November 2005</td>
<td>In a document on the pipeline project – which was one of the main focuses of the Russo-Japanese summit in Tokyo, just weeks after Fradkov’s meeting with Wen Jiabao, Russia promised Japan that it will build a Pacific-bound oil pipeline linking eastern Siberia with the Russian Far East. However, Russia fell short of setting a date for constructing it, and some have suggested that despite public statements to the contrary, Russia looks set to have the eastern Siberian oil line serve China before Japan.</td>
<td></td>
</tr>
<tr>
<td>December 2005</td>
<td>Russia started implementing a project to build the Taishet-Skovorodino pipeline, and Transneft and CNPC got engaged in talks to build a pipeline segment from Skovorodino to China.</td>
<td></td>
</tr>
<tr>
<td>March 2006</td>
<td>According to memoranda signed during Putin’s visit to China, over the next 15 years Russia will most likely become the largest energy supplier to China.</td>
<td></td>
</tr>
<tr>
<td>April 2006</td>
<td>The construction of the Taishet-Skovorodino pipeline was launched.</td>
<td></td>
</tr>
<tr>
<td>July 2006</td>
<td>Putin said that he could not give Japan guarantees that a planned Far Eastern pipeline would eventually reach the Pacific coast, citing uncertainty about oil supplies.</td>
<td></td>
</tr>
</tbody>
</table>
## APPENDIX 4: Timeline of Oil Industry Bargaining in Venezuela

<table>
<thead>
<tr>
<th>Date</th>
<th>Event</th>
</tr>
</thead>
<tbody>
<tr>
<td>February 1999</td>
<td>Chávez came to power</td>
</tr>
<tr>
<td>January 2002</td>
<td>Venezuela’s 2001 Hydrocarbons Law, which raised royalties paid by private companies to 20 – 30 percent from the previous 1 – 16.66 percent, and from 1 to 16.66 percent for those producing from the tar sands, came into effect but not in practice as of yet; at the same time, the government increased a corporate tax rate for oil companies from ‘preferential rate’ of 34 percent to 50 percent; the law also guaranteed PdVSA at least 51 percent stake in any project regarding exploration, production, transportation and initial storage of oil</td>
</tr>
<tr>
<td>April 2002</td>
<td>U.S. intelligence agencies provided support to Venezuelan military personnel who had briefly toppled Chávez</td>
</tr>
<tr>
<td>December 2002</td>
<td>Nationwide strike, organised by opponents of President Chávez, was also joined by the employees from PdVSA, shutting down a large portion of the country’s oil industry and drastically reducing the production of Venezuelan oil and its delivery to internal and external markets; Chávez declared the strikers’ demands, which called for an early referendum on the President’s rule, unconstitutional and dismissed around half (18,000) of PdVSA’s total workforce (32-40,000). Chávez then took full control of the company and put political loyalists in charge</td>
</tr>
<tr>
<td>October 2004</td>
<td>The new law came into practice when Chávez surprised the IOCs by announcing on his weekly radio broadcast that he was increasing royalties paid to the state by companies involved in heavy crude production in the Orinoco Tar Belt</td>
</tr>
<tr>
<td>November 2004</td>
<td>Venezuela and Russia concluded an agreement setting the stage for Venezuelan purchases of Russian arms; agreements on energy and other matters were also signed</td>
</tr>
<tr>
<td>December 2004</td>
<td>Chávez inaugurated Rafael Ramirez, a political loyalist, in charge of both PdVSA and the MEP</td>
</tr>
<tr>
<td></td>
<td>Chávez was reported to have referred to Venezuela’s long oil-producing history as “100 years of domination by the United States.” He asserted that “Now we are free and place this oil at the disposal of the great Chinese fatherland.”</td>
</tr>
<tr>
<td>January 2005</td>
<td>Venezuela signed 19 bilateral oil and gas agreements with China in order to increase exports to Beijing in exchange for the promise of future Chinese investment in Venezuelan oilfields</td>
</tr>
<tr>
<td>February 2005</td>
<td>Chávez threatens to cut oil supplies to the US</td>
</tr>
<tr>
<td></td>
<td>Rosoboron eksport signed a contract to sell 100,000 Kalashnikov rifles to Venezuela, and in addition to this deal, Moscow has offered Venezuela the opportunity to manufacture Kalashnikovs under license</td>
</tr>
<tr>
<td>March 2005</td>
<td>A delegation from Tehran visited Caracas, and PDVSA employees are now getting technical training from Iran</td>
</tr>
<tr>
<td></td>
<td>Russian and Venezuelan representatives signed a $120 million agreement for Venezuela to purchase nine attack and one transport helicopters, first three of which were delivered in December 2005; additionally, there are indications that Caracas may purchase another 34 Russian helicopters and 50 MiG-29 fighter aircraft to replace its fleet of 22 American-made F-16s; an agreement on cooperation in the energy sphere was signed that envisions Russian firms building petrochemical and power plants in Venezuela as well as participating in oil and gas exploration, extraction, refining, and transport; Russian firms will also engage in modernising the Venezuelan coal industry</td>
</tr>
<tr>
<td>April 2005</td>
<td>The Venezuelan Energy Minister, Rafael Ramirez, announced that</td>
</tr>
</tbody>
</table>

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operating strategic operating agreements (essentially RSAs) between PDVSA and foreign companies would be terminated as from December 31, 2005, with a grace period of six months for companies who are parties to operating contracts.

**May 2005**

The IOCs operating in the country have been compared to Yukos and ordered to pay between $2 and 3 billion in back taxes for the last ten years.

The first ever tanker with 1.8 million barrels of crude left Venezuela for China.

**July 2005**

Tax auditors raided a Chevron office in Maracaibo, city in western Venezuela.

**August 2005**

Royal Dutch/Shell’s office in Maracaibo was closed by the Venezuelan tax agency for challenging its $132 million tax bill, which was given to Shell in July 2005.

Venezuela opened its first oil office in China.

Chávez wins 59 percent of the public vote in a plebiscite that kept him in office.

**October 2005**

Caracas had hinted specifically that future investments in the Orinoco Tar Belt would be subject to higher royalties and that the current terms would be renegotiated at some point.

22 of the 32 operating agreements signed by foreign oil companies with PDVSA have been migrated to the new regime.

**November 2005**

After the signing of two contracts for crude and fuel oil between CNPC and PDVSA, Venezuela is to double oil sales to China, to 160,000 bpd average in 2006, with plans to bring this to 300,000 by the end of 2006.

Venezuela’s government took control of two oilfields, one operated by France’s Total and the other by ENI of Italy, after the companies refused to sign up to new arrangements converting their operating contracts into JVs in which PDVSA will have a majority stake.

Venezuela has begun to ship around 2 million barrels of oil per month to India.

**Early April 2006**

After all 32 oil fields have been shifted to joint ventures, rumours have started that four heavy oil projects in the eastern Orinoco River basin, where Exxon Mobil, Chevron, Total, BP, Conoco Phillips and Statoil convert extra heavy crude into some 600,000 bpd of synthetic crude using specialised refineries, could follow suit in near future; In addition, it was suggested that the companies involved could see income taxes increased to 50 percent from 34 percent and royalties hiked to 30 percent from 16.66 percent.

**May 2006**

Chávez increased royalties for all companies involved in the country not to 30, but to 33.3 percent; the income tax was also been raised, as predicted, to 50 percent from 34 percent.

PDVSA announced that it planned to buy 18 oil tankers from Chinese shipyards at a cost of $1.3 billion to allow for increased shipments to China.

**July 2006**

On his visit to Tehran, where after pledging that Venezuela would “stand by Iran at any time and under any condition,” Chávez invited Iranian investment in Venezuela’s oil industry.

CITGO announced plans to reduce its network of U.S. gas stations by 14 percent, to 11,200.

**August 2006**

CITGO sold a 42.1 percent share in the Lyondell-CITGO refinery in the U.S., for $2.3 billion.

**November 2006**

Chávez again threatens to cut oil supplies to the US.

**December 2006**

Chávez wins 63 percent of votes in a presidential election.
<table>
<thead>
<tr>
<th>Date</th>
<th>Event Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Late February 2007</td>
<td>Chávez signed a decree for the government to take a majority stake in four heavy crude upgrading projects in the Orinoco River basin by May 1, 2007</td>
</tr>
<tr>
<td>March 2007</td>
<td>Chávez said Venezuela was on track to reach its goal of raising oil sales to China to 1 million barrels a day by 2012 as he announced plans for Venezuela and China to build three refineries in China that will process a total of 800,000 barrels a day of heavy Venezuelan crude, to be ready within three years. He also said the two countries decided to start a joint oil shipping company with its own tankers to carry crude and other products between Venezuela and China.</td>
</tr>
<tr>
<td>Early April 2007</td>
<td>Rafael Ramírez sent a chilling signal to the US, saying Venezuela might sell refineries in Texas and Louisiana that process crude from Exxon’s Venezuelan oil fields.</td>
</tr>
</tbody>
</table>
## APPENDIX 5: Timeline of Bargaining for UNOCAL

<table>
<thead>
<tr>
<th>Date</th>
<th>Event</th>
</tr>
</thead>
<tbody>
<tr>
<td>April 4, 2005</td>
<td>Directors of UNOCAL accepted a $16.5 billion offer to be bought by Chevron; the offer was one quarter in cash and three quarters in Chevron stock</td>
</tr>
<tr>
<td>June 22, 2005</td>
<td>CNOOC made a counteroffer of $18.5 billion in cash, financed in part by low interest rate loans from its state-owned parent company</td>
</tr>
<tr>
<td>June 30, 2005</td>
<td>The U.S. Congress passed a resolution by 398 to 15 expressing national security concerns about the acquisition of UNOCAL by the CNOOC</td>
</tr>
<tr>
<td>July 13, 2005</td>
<td>In a congressional hearing, Frank Gaffney Jr., President of the Center for Security Policy, told the House Armed Services Committee that the sale of UNOCAL to CNOOC “would have adverse effects on the economic and national security interests of the United States.” He pointed to “the folly of abetting communist China’s effort to acquire more of the world’s relatively finite energy resources” and warned of “the larger and ominous Chinese strategic plan of which this purchase is emblematic”</td>
</tr>
<tr>
<td>Mid July 2005</td>
<td>Chevron increased its bid to $17.7 billion, turning up the heat on CNOOC to respond with a higher bid of its own</td>
</tr>
<tr>
<td>July 19, 2005</td>
<td>The Chevron-UNOCAL merger accepted by UNOCAL</td>
</tr>
<tr>
<td>July 26, 2005</td>
<td>House Resolution (H.R. 6) was amended to require that the Department of Energy (DOE), along with the Departments of Defense and Homeland Security, conduct a 120-day study on the economic and security implications of China’s growing demand for energy. An important provision of that amendment was that the White House could not approve the CNOOC offer until 21 days after the DOE study was completed. Hence, by adding as much as 141 days to the takeover process, Congress undermined CNOOC’s incentive to continue the bidding war with Chevron</td>
</tr>
<tr>
<td>August 2, 2005</td>
<td>CNOOC withdrew its bid, thus leaving it to Chevron to complete the takeover</td>
</tr>
<tr>
<td>August 10, 2005</td>
<td>The Chevron-UNOCAL merger completed</td>
</tr>
</tbody>
</table>
# APPENDIX 6: Timeline of Bargaining for the Future of ANWR

<table>
<thead>
<tr>
<th>Date</th>
<th>Event</th>
</tr>
</thead>
<tbody>
<tr>
<td>May 1998</td>
<td>The U.S. Geological Survey (USGS) issued revised estimates of oil and gas resources in the 1002 Area; the 1998 USGS assessment showed an overall increase in estimated oil resources when compared to all previous government estimates; the estimate reaffirmed the 1002 Area’s potential as the single most promising prospect in the United States; the total quantity of recoverable oil within this entire assessment area is estimated between 5.7 and 16 billion barrels, with a mean value of 10.4 billion barrels.</td>
</tr>
<tr>
<td>February 2001</td>
<td>Republican Senator Frank Murkowski, Senator for Alaska and Chairman of the Senate Energy and Natural Resources Committee, introduced his <em>National Energy Security Act 2001</em>; Title V of this bill outlined a program for the development of oil and gas resources thought to be present under Area 1002 of ANWR.</td>
</tr>
<tr>
<td>May 2001</td>
<td>The <em>National Energy Policy</em> report asserted that: “Measures to enhance energy security … must begin at home … The first step towards a sound international energy policy is to use our own capability to produce, process and transport energy resources we need;” in what is to be “environmentally responsible energy development,” the NEP recommended opening up the ANWR to oil companies for drilling; the National Energy Policy Development (NEPD) Group, headed by the Vice-President Dick Cheney and the Secretary of State Colin Powell, recommended that President Bush directs the Secretary of the Interior to work with Congress to authorise exploration and, if resources are discovered, development of the 1002 Area of ANWR.</td>
</tr>
<tr>
<td>October 2001</td>
<td>The Interior Secretary Gale A. Norton, announced the start-up of a controversial new oilfield in Alaska’s Beaufort Sea – the Northstar field operated by BP. The Northstar project had been strongly opposed by US environmentalists and Norton’s declaration demonstrated a new willingness to ride roughshod over them.</td>
</tr>
<tr>
<td>March 2002 / March 2003</td>
<td>Senator Murkowski and Senator Jim Inhofe from Oklahoma tried to attach a drilling provision to a massive $345 billion defence bill, immediately following the World Trade Center attack; Murkowski and other Republicans tried to convince senators that opening the refuge was now a matter of national energy security; However, the Senate Majority Leader Democrat Tom Daschle managed to keep the ANWR provision out of the defence bill.</td>
</tr>
<tr>
<td>March 2004</td>
<td>The House repeatedly approves drilling in the refuge as part of broad energy legislation, but the Senate rejects drilling, unable to overcome a Democratic-lead filibuster.</td>
</tr>
<tr>
<td>November 2004</td>
<td>The Congress passed its budget resolution for 2005 with no mention of oil and gas revenues from the Arctic Refuge.</td>
</tr>
<tr>
<td>March 2005</td>
<td>The Senate inserted into the budget revenue provision that anticipated oil lease sales in ANWR; a Democratic-lead attempt to strip the provision from the budget measure fell short by 49 votes to 51, and therefore this provision became immune to a Democratic filibuster; the budget document became a vehicle for authorising ANWR oil drilling.</td>
</tr>
<tr>
<td>April 2005</td>
<td>The bill, which called for drilling for oil in the ANWR was approved by the House of Representatives.</td>
</tr>
<tr>
<td>August 2005</td>
<td>The Energy Policy Act of 2005, a statute that was passed by the Congress on July 29, and signed into law on August 8, did not include the provision from the original bill, which called for drilling for oil in the ANWR.</td>
</tr>
<tr>
<td>December 2005</td>
<td>Senator Ted Stevens (R-AK) attached Arctic Refuge drilling language to the annual defence appropriation bill; however, a bipartisan group of Senators led</td>
</tr>
</tbody>
</table>
a successful filibustering of the bill, and the language was subsequently removed from the bill

<table>
<thead>
<tr>
<th>Date</th>
<th>Event</th>
</tr>
</thead>
<tbody>
<tr>
<td>March 2006</td>
<td>While the Senate was busy passing a largely symbolic budget amendment in support of opening the ANWR to drilling, Prudhoe Bay faced the largest ever spill to hit Alaska’s North Slope, as 760,000 litres of crude escaped; the budget resolution had, as in 2002 and 2003, fallen a few votes short of the 60 needed to block a Democrat-led filibuster.</td>
</tr>
<tr>
<td>May 2006</td>
<td>The Congress passed the American-Made Energy and Good Jobs Act, which would open ANWR to development. Moreover, a new proposal to open ANWR for drilling was launched by Richard Pombo (R), the Chairman of the House Resources Committee, but together with the American-Made Energy and Good Jobs Act was later blocked by the Senate.</td>
</tr>
<tr>
<td>August 2006</td>
<td>BP closed the Prudhoe Bay oilfield due to a leak caused by corrosion on an oil transit line; the TAPS was to be closed until 26 km of this ageing pipeline have been inspected and repaired; the bottom-line is that oil companies, which are focused on their economic gains, cannot be trusted to protect Alaska’s fragile environment.</td>
</tr>
<tr>
<td>November 2006</td>
<td>After mid-term elections, both the U.S. Congress and the U.S. Senate became controlled by the Democrats, who are most likely opposed to drilling in Alaska.</td>
</tr>
<tr>
<td>Date</td>
<td>Event</td>
</tr>
<tr>
<td>-------------</td>
<td>----------------------------------------------------------------------</td>
</tr>
<tr>
<td>1995</td>
<td>Buyback contracts designed</td>
</tr>
<tr>
<td>Early March</td>
<td>Conoco, an American IOC, offered a lucrative $1.6 billion contract to develop two Iranian offshore oil fields</td>
</tr>
<tr>
<td>Mid March</td>
<td>President Clinton signed an executive order that bars American companies from conducting business with Iran; Clinton’s decree stops American companies from purchasing Iranian crude oil;</td>
</tr>
<tr>
<td>May 1995</td>
<td>Decree was extended after President Clinton had formally declared a national state of emergency between Iran and the United States, claiming “an extraordinary threat to the national security, foreign policy and economy of the U.S. constituted by the actions and policies of the government of Iran.”</td>
</tr>
<tr>
<td>1996</td>
<td>The U.S. Congress adopted the Iran and Libya Sanctions Act (ILSA), imposing severe penalties on non-U.S. firms that invest more than $20 million in Iran’s oil industry</td>
</tr>
<tr>
<td>November</td>
<td>The European Union opposed the enforcement of ILSA sanctions on its members, and it passed Resolution 2271 directing EU members not to comply with ILSA</td>
</tr>
<tr>
<td>1997</td>
<td>Moderate president Khatami elected in Iran</td>
</tr>
<tr>
<td>August</td>
<td>Executive Order (decree) consolidated and clarified by the Clinton administration</td>
</tr>
<tr>
<td>September</td>
<td>When the French company TotalFinaElf and the Russian giant Gazprom struck a $2 billion deal with Iran to develop the huge offshore South Pars field in the Persian Gulf, Washington issued thinly veiled threats to fine the company’s branches in the United States</td>
</tr>
<tr>
<td>1999</td>
<td>Azadegan oil field discovered, representing Iran’s largest oil discovery in 30 years</td>
</tr>
<tr>
<td>August</td>
<td>Japanese Foreign Minister Komura Masahiko’s visit to Iran, and the resumption of yen loans</td>
</tr>
<tr>
<td>November</td>
<td>President Khatami visited Tokyo and announced that his government would give Japan preference in negotiations over the development of Azadegan oil field</td>
</tr>
<tr>
<td>January</td>
<td>The Majlis approved development of Azadegan by foreign investors using the “buyback” model</td>
</tr>
<tr>
<td>August</td>
<td>ILSA extended for five years</td>
</tr>
<tr>
<td>September</td>
<td>After September 11, 2001, suddenly Tokyo began putting much greater emphasis on the U.S.-Japan security alliance, and became more fearful of doing anything that would have annoyed Washington at that volatile time</td>
</tr>
<tr>
<td>January</td>
<td>In his State of the Union speech, President Bush identified Iran as one of the countries that support terrorism and included it in his “Axis of Evil”</td>
</tr>
<tr>
<td>June</td>
<td>The E.U. gave the green light to launch formal trade relations with Iran, despite heavy pressure against this from the U.S.</td>
</tr>
<tr>
<td>August</td>
<td>An Iranian opposition group publicly disclosed the locations of two previously secret nuclear facilities in Iran</td>
</tr>
<tr>
<td>December</td>
<td>The White House expressed great concerns over two secret Iranian nuclear plants, which it charged could be used to produce parts of nuclear weapons; on the same day, Iran asserted that the suspect construction sites were for peaceful purposes, and were fully open to United Nations nuclear experts</td>
</tr>
<tr>
<td>Month</td>
<td>Event Description</td>
</tr>
<tr>
<td>------------</td>
<td>---------------------------------------------------------------------------------------------------------------------------------------------------</td>
</tr>
<tr>
<td>March 2003</td>
<td>Executive decree from August 1997 continued by President Bush. Iran and India conducted a joint naval exercise that was possibly motivated on Tehran’s part by the U.S. naval presence in the Persian Gulf.</td>
</tr>
<tr>
<td>June 2003</td>
<td>The business negotiations between Iranians and the Japanese were more-or-less complete, and all that had to be done was to seal the agreement; Tokyo had kept Washington informed, and so just before the deal was to be signed, the Bush Administration launched a diplomatic offensive on Tokyo; National Security Adviser Condoleezza Rice, Secretary of State Colin Powell, and Deputy Secretary of State Richard Armitage threatened Tokyo: Signing this deal with Tehran could damage the U.S.-Japan alliance; they brought up the nuclear issue in Iran as a main concern, and in addition, pointed that Iran supported terrorists and had close relationship with North Korea.</td>
</tr>
<tr>
<td>July 2003</td>
<td>Iranian Foreign Minister Kamal Kharrazi released a statement that if Japan failed to act, then Iran would begin negotiating with China, India, and/or Russia on the Azadegan deal; Tehran said that they still preferred Japan to other candidates, and that they would not give up on the negotiations. Richard Boucher, the State Department’s spokesman, said that this was a “particularly unfortunate time” to be striking deals with Iran.</td>
</tr>
<tr>
<td>August 2003</td>
<td>Kharrazi visited Tokyo and urged Japanese leaders to defy the U.S. pressure.</td>
</tr>
<tr>
<td>2004</td>
<td>Hardliners take control of the Majlis.</td>
</tr>
<tr>
<td>Early 2004</td>
<td>Japan sent 550 of its Self-Defense Forces (SDF) to Samawa, Iraq, in accordance with Washington’s strong wishes and this may have made Tokyo feel more secure about defying the Bush administration on Iran.</td>
</tr>
<tr>
<td>February 2004</td>
<td>A Japanese consortium led by Inpex finally went ahead with the $2 billion Azadegan deal and signed the agreement.</td>
</tr>
<tr>
<td>March 2004</td>
<td>President Bush extended presidential decree on Iran, citing the “unusual and extraordinary threat” to U.S. national security posed by Iran.</td>
</tr>
<tr>
<td>August 2004</td>
<td>Washington prodded Tokyo to cancel the Azadegan deal and pursue oil interests in Libya instead however, Tokyo did not accept this offer.</td>
</tr>
<tr>
<td>October 2004</td>
<td>The ambitious Memorandum of Understanding signed between Iran and China (through Sinopec); under this agreement, China may buy between $70 billion and $100 billion of Iranian oil and natural gas over the next 30 years, while developing Yadavaran, Iran’s biggest onshore oilfield, and South Pars fields in the Persian Gulf, the largest natural gas reserve on the planet; after the oil and natural gas agreement had been signed, Li Zhaoxing, the Chinese foreign minister, paid a visit to Iran, saying that China saw “no reason” to refer Iran’s nuclear program to the UN.</td>
</tr>
<tr>
<td>January 2005</td>
<td>The state run Indian Oil Corp. reached an agreement with the Iranian firm Petropars to develop a gas block in the gigantic South Pars gas field.</td>
</tr>
<tr>
<td>February 2005</td>
<td>Moscow and Tehran concluded an agreement under which spent nuclear fuel from Bushehr nuclear plant, which Russia works to complete, and which is to be fully operational by November 2007, would be shipped back to Russia.</td>
</tr>
<tr>
<td>June 2005</td>
<td>The election of hardline president Mahmoud Ahmadinejad in Iran; Chinese President Hu Jintao was among the first to congratulate Ahmadinejad on his victory.</td>
</tr>
<tr>
<td>September 2005</td>
<td>Both China and Russia abstained in the vote which declared Iran in violation of its NPT commitments for having hidden its enrichment.</td>
</tr>
<tr>
<td>Date</td>
<td>Event</td>
</tr>
<tr>
<td>--------------</td>
<td>---------------------------------------------------------------------------------------------------------------------------------------</td>
</tr>
<tr>
<td>December 2005</td>
<td>Russia confirmed a deal to sell 30 surface-to-air (Tor M1) missile systems to Iran for $1 billion, drawing criticism from the United States and Israel</td>
</tr>
<tr>
<td>February 2006</td>
<td>The IAEA concluded that Iran was in pursuit of nuclear weapons and the issue was referred to the U.N. Security Council</td>
</tr>
<tr>
<td>March 2006</td>
<td>Joint Economic Committee of the U.S. Congress issued a research report on Iran’s oil and gas wealth arguing that “ILSA is believed to have limited Iran’s oil production capabilities”</td>
</tr>
<tr>
<td></td>
<td>U.S. Deputy Secretary of State Robert Zoellick had “informally” asked Tokyo to write off its investment in Azadegan</td>
</tr>
<tr>
<td></td>
<td>Iranian Interior Minister Mostafa Pourmohammadi argued that, “If they [the U.N. Security Council] politicise our nuclear case, we will use any means. We are rich in energy resources. We have control over the biggest and most sensitive energy route of the world… No means [for reprisals] will be ignored and we will not disregard any means.”</td>
</tr>
<tr>
<td></td>
<td>President Bush extended the presidential decree on Iran</td>
</tr>
<tr>
<td>Late March 2006</td>
<td>Iran given a 30 days ultimatum to return to the negotiating table or face isolation</td>
</tr>
<tr>
<td></td>
<td>Russia and China refused to have Iran’s nuclear activities declared “a threat to peace and security,” since this could open the door to tougher action in future</td>
</tr>
<tr>
<td>April 2006</td>
<td>ILSA tightened, codified, and renamed to Iran Freedom and Support bill by the Congress</td>
</tr>
<tr>
<td>May 2006</td>
<td>Tehran suggested that if Japan went cold on the Azadegan deal under the threat of the U.S. sanctions, and did not begin work on the field by September 22, 2006, then China or Russia will be happy to step in</td>
</tr>
<tr>
<td>Early June 2006</td>
<td>Iran’s supreme leader, Ayatollah Ali Khamenei, threatened to block oil from leaving the Persian Gulf if Iran’s security was in danger: “Beware, if you make the slightest mistake over Iran, the energy flow through this region will be seriously in danger.”</td>
</tr>
<tr>
<td>August 2006</td>
<td>Tehran again suggested that others might step in to develop Azadegan if Japan does not begin work before the deadline</td>
</tr>
<tr>
<td>October 2006</td>
<td>Japan’s inaction and its inability to stay in the game resulted in its Azadegan oil concession reduced to 10 percent from 75 percent.</td>
</tr>
<tr>
<td>April 2007</td>
<td>Iran announced that it could produce nuclear fuel on an industrial scale, and warned that it would review its NPT membership if further pressure was applied by the West over its nuclear programme</td>
</tr>
</tbody>
</table>
APPENDIX 8: Measurement of the IOC-Host State Bargaining Model Variables

Methodology

Each variable is awarded a score for Iran, Russia, and Venezuela for both 1998/99 and 2005/06. The score indicates relative bargaining power between IOCs and these three host states. The score for each variable is determined according to the following scale (possible scores within each category in brackets):

4.00-5.00 = very high (4.00, 4.25, 4.50, 4.75, 5.00)
3.00-3.99 = high (3.00, 3.25, 3.50, 3.75)
2.00-2.99 = medium (2.00, 2.25, 2.50, 2.75)
1.00-1.99 = low (1.00, 1.25, 1.50, 1.75)
0.00-0.99 = very low (0.00, 0.25, 0.50, 0.75)

Higher the score, more powerful the host government vis-à-vis the IOCs, and lower the score, more powerful the IOCs vis-à-vis the host government. Thus, while score of 5.00 indicates the highest possible relative host state’s power against the IOCs, 0.00 indicates the highest possible relative power of IOCs vis-à-vis the host state. A score of 2.50 indicates bargaining power equilibrium. Please not that each score has been assigned most objectively, based on much evidence, thought and analysis. While assigning scores in this manner may be considered arbitrary and unscientific, it best served my objective of providing a coherent picture of the actual bargaining power relationship between host states and the IOCs, since the large number of variables prohibited me from engaging in graspable and unambiguous qualitative analysis.

Measurement

Industry and Country Context

1) Reserve Size

Russia, Venezuela and Iran all possess high crude oil reserves. When one considers changes in official oil reserves of Iran, Russia, and Venezuela between 1998 and 2005, it is important to emphasise that Venezuela and Russia’s oil reserves grew by 19.4 and 3.6 billion barrels, respectively. This is reflected in higher score for Russia, but not in the case of Venezuela. Meanwhile, Iran’s official reserves grew considerably after discovery of Azadegan field. Thus, this is reflected in the increase of Iran’s score.

<table>
<thead>
<tr>
<th></th>
<th>Iran</th>
<th>Russia</th>
<th>Venezuela</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reserves (billion barrels)</td>
<td>93.7</td>
<td>137.5</td>
<td>55.0</td>
</tr>
<tr>
<td>World Rank</td>
<td>5</td>
<td>2</td>
<td>7</td>
</tr>
<tr>
<td>Score</td>
<td>4.25 (VH)</td>
<td>4.50 (VH)</td>
<td>3.75 (H)</td>
</tr>
</tbody>
</table>

Source: BP, Statistical Review of World Energy 2006. Note: Higher the reserves, higher the score

2) Reserve Longevity
While Iran and Venezuela’s R/P ratios increased between 1998 and 2005 by 26.4 and 12.7 years, respectively, Russia R/P ratio dropped by 3.4 years. This is reflected in the increase of Iran and Venezuela’s score, and the fall in Russia’s score between 1998 and 2005.

<table>
<thead>
<tr>
<th></th>
<th>Iran</th>
<th>Russia</th>
<th>Venezuela</th>
</tr>
</thead>
<tbody>
<tr>
<td>1998 R/P Ratio</td>
<td>66.6</td>
<td>24.8</td>
<td>59.9</td>
</tr>
<tr>
<td>2005 R/P Ratio</td>
<td>93.0</td>
<td>21.4</td>
<td>72.6</td>
</tr>
</tbody>
</table>

3) Potential Profitability

A barrel of oil costs $2-4 to explore and produce in Iran, between $6-12 in Russia, and around $4.50 in Venezuela, except for Orinoco Tar Belt, where it stands at anywhere up to, but not exceeding $18. It is important to note that while exploration and production costs in Iran, Russia, and Venezuela have not changed considerably since 1998, the oil prices increased dramatically. On one hand, when oil prices stand at $14-15 a barrel, as they did in 1998, very little economic rent is to be divided between the host government and the IOCs, and potential profitability is low. On the other hand, when oil market prices are at over $50 a barrel, as they were in 2005, one could see a lot of economic rent divided before a barrel that has been produced in Iran, Russia, and Venezuela reaches the markets, and thus all three countries were awarded with a higher score for 2005 than for 1998.

<table>
<thead>
<tr>
<th></th>
<th>1998</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Avg. Oil Price</td>
<td>$14.36/barrel (WTI)</td>
<td>$56.51/barrel (WTI)</td>
</tr>
<tr>
<td>Production Cost</td>
<td>Iran $2-4</td>
<td>Russia $6-12</td>
</tr>
<tr>
<td></td>
<td>Iran $2-4</td>
<td>Russia $6-12</td>
</tr>
<tr>
<td>Score</td>
<td>3.25 (H)</td>
<td>2.50 (M)</td>
</tr>
<tr>
<td></td>
<td>4.50 (VH)</td>
<td>4.00 (VH)</td>
</tr>
</tbody>
</table>


4) Level of Economic Development

Both in 1998 and 2005 Iran, Russia and Venezuela were developing or transition countries with medium levels of economic development. This brings us to the situation in which it is hard to establish whether IOCs or host governments of these three countries possess relative bargaining advantage, and the scores are reflective of this.
### Table 5.1: GDP/PPP Per Capita and Score

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>GDP/PPP Per Capita</strong></td>
<td>$5,000</td>
<td>$8,100</td>
<td>$4,000</td>
<td>$10,700</td>
<td>$8,500</td>
<td>$6,500</td>
</tr>
<tr>
<td><strong>Score</strong></td>
<td>2.25 (M)</td>
<td>2.50 (M)</td>
<td>2.00 (M)</td>
<td>2.75 (M)</td>
<td>2.75 (M)</td>
<td>2.00 (M)</td>
</tr>
</tbody>
</table>


#### 5) Barriers to Entry

Low entry barriers, evident in Russia (privatisation and PSA Law) and Venezuela (*la apertura*) in the mid and late 1990s indicated that these countries required IOC presence in their oil industries and low barriers served as an invitation to IOCs. This is reflected in low scores for both Russia and Venezuela for 1998/99. Alternatively, when barriers to entry are high, and I showed in case study chapters that they currently are high in Venezuela, Russia and especially Iran, this shows that host countries are unwelcoming and do not want or need IOCs. Therefore, their bargaining power against the IOCs is positively affected, which is evident in higher scores for all three countries in 2005/06. Note that despite Khatami’s attempt at liberal reform in Iran in the 1990s, nothing similar to Venezuela’s *la apertura* or Russia’s privatisation, followed by the PSA Law, took place in Iran, and this is reflected in high score for 1998/99. Even higher score for Iran in 2005/06 is reflective of current leadership’s antagonism for any such reform.

<table>
<thead>
<tr>
<th></th>
<th></th>
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<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Score</strong></td>
<td>3.50 (H)</td>
<td>4.25 (VH)</td>
<td>1.75 (L)</td>
<td>4.00 (H)</td>
<td>1.25 (L)</td>
<td>4.00 (H)</td>
</tr>
</tbody>
</table>

Note: Higher the barriers, higher the score.

#### 6) Strategic Importance of the Industry

Oil is strategically very important for Russia, and particularly Iran and Venezuela. This can be seen from the share of oil export revenues in these countries’ overall export earnings and GDP for 1998 and 2005. Moreover, the strategic importance measured in these terms, increased between 1998 and 2005. Likewise, importance of oil in other bargaining arenas also increased for Iran (in the nuclear issue), Russia (for reclaiming great power status) and Venezuela (for spreading Bolivarian Revolution). This is all reflected in higher scores for all three countries in 2005 when compared to 1998.

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>of GDP</strong></td>
<td>8.5%</td>
<td>24.6%</td>
<td>15.9%</td>
<td>16.4%</td>
<td>12.3%</td>
<td>34.3%</td>
</tr>
<tr>
<td><strong>of export earnings</strong></td>
<td>76.6%</td>
<td>80.5%</td>
<td>24.3%</td>
<td>49.6%</td>
<td>66.8%</td>
<td>86.6%</td>
</tr>
<tr>
<td><strong>In other bargaining arenas</strong></td>
<td>medium</td>
<td>very high</td>
<td>low</td>
<td>high</td>
<td>medium</td>
<td>very high</td>
</tr>
<tr>
<td><strong>Score</strong></td>
<td>3.50 (H)</td>
<td>4.50 (VH)</td>
<td>2.75 (M)</td>
<td>3.75 (H)</td>
<td>3.50 (H)</td>
<td>4.75 (VH)</td>
</tr>
</tbody>
</table>


7) Cultural/Political Context

The 1990s in Venezuela and Russia witnessed opening of these countries’ oil industries to foreign investment due to favourable political context. However, in this decade both countries have become increasingly hostile and opposed to the IOC involvement, due to the changed political context. As evident from the case study chapters, both countries need government control of oil to further their goals in other bargaining arenas (such as domestic and international politics). Likewise, anti-British and anti-American sentiment in Iran and Iranian pursuit of nuclear technology is resulting in slow removal of Western IOCs from the country. American IOCs have not been present there since mid-1990s and European IOCs have recently been discouraged from investing there. Where strong nationalist feeling exists, as nowadays in Russia, Iran and Venezuela, it is “particularly likely to be directed at foreign oil companies,” since oil is a non-renewable resource and it carries a lot of strategic significance. Additionally, when dealings between the government and companies are widely publicised in the press and other media, as they are in Iran, Russia, and Venezuela, the government tends to have a bargaining advantage, since IOCs are often portrayed as foreign interlopers, the government can utilise public opinion to sway negotiations toward more favourable outcomes. Therefore, due to these developments, bargaining power of Western IOCs vis-à-vis the host governments of Iran, Russia and Venezuela is weakened, and this is clearly reflected in the scores for 2005/06 when compared to 1998/99.

<table>
<thead>
<tr>
<th></th>
<th>Iran</th>
<th>Russia</th>
<th>Venezuela</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>3.75 (H)</td>
<td>4.75 (VH)</td>
<td>2.25 (M)</td>
</tr>
</tbody>
</table>

Note: More hostile the context higher the score

8) Competition

The IOCs face higher level of competition in Iran, Russia and Venezuela in the current decade than they did in the 1990s, and this carries a negative effect on their bargaining power against governments of these countries. While competition in Iran might be lower than in Russia and Venezuela due to the absence of American IOCs and service companies, it is still high due to the presence of developing countries’ NOCs. Many of these countries, particularly China, maintain close relationship with the Iranian regime. Local service companies also offer important services to the NIOC. An NIOC manager explained their perspective:

Service companies can provide services often at a better cost than IOCs. This is also true with Iranian service companies. They can do exploration services, seismic, drilling, tankers…. There are many, many alternatives to IOCs.

In Venezuela, there are a wide variety of IOCs, developing countries’ NOCs (again, favoured by the government) and service companies, and therefore, industry concentration is very low. In Russia, although the industry concentration is not as low as in Venezuela, this is primarily due to the government consolidation. Russian private, and at the same time Kremlin-friendly oil

1203 See Grosse, Multinationals in Latin America, p. 83.
1204 Marcel, “Investment in Middle East Oil,” p. 7.
1205 Quoted in Marcel, Oil Titans, p. 213.
companies (i.e. Lukoil, Surgutneftegaz), government-owned companies (Gazprom, Rosneft), both of which “consider international majors as competitors,” together with many service and consultancy firms, offer staunch competition to the IOCs. Therefore, whereas in the mid and late 1990s the IOCs did not face too much competition, in 2005/06, competition negatively affected their bargaining power in Iran, Russia and Venezuela, and this is reflected in the scores below.

<table>
<thead>
<tr>
<th></th>
<th>Iran</th>
<th>Russia</th>
<th>Venezuela</th>
</tr>
</thead>
<tbody>
<tr>
<td>Score</td>
<td>2.25 (M)</td>
<td>3.75 (H)</td>
<td>2.00 (M)</td>
</tr>
</tbody>
</table>

Note: Higher the competition, higher the score

9) World Oil Market Prices

When oil prices are low, and when IOCs have little cash available, as in the latter parts of the 1980s and for most of the 1990s oil executives are courted by commodity-rich countries to develop their national resources. Due to low amounts of oil exports revenues host governments are needy of foreign investment in their oil industry. Therefore, their bargaining power against the IOCs is negatively affected. However, when prices rise, as they did in early years of the new millennium, host governments have a tendency to rethink their contracts and seek higher taxes and royalties. Thus, host governments endowed with a lot of capital are not as needy of foreign investment. In this case, their bargaining power vis-à-vis that of the IOCs is positively affected.

<table>
<thead>
<tr>
<th>Average Oil Price</th>
<th>1998</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>$14.36/barrel (WTI)</td>
<td>$56.51/barrel (WTI)</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Score</th>
<th>Iran</th>
<th>Russia</th>
<th>Venezuela</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1.50 (L)</td>
<td>4.00 (VH)</td>
<td></td>
</tr>
</tbody>
</table>

Note: Higher the price, higher the score

10) Level of Political and Economic Risk

In 2006, both Iran and Venezuela were considered as high risk countries, while Russia was considered as a medium risk country. Except for Russia, this is similar to the situation in 1998. Therefore, with slight variations, all three countries are continuously disadvantaged in their dealings with the IOCs due to high political and economic risks associated with investing in these countries.

<table>
<thead>
<tr>
<th>Moody’s Credit Rating</th>
<th>Iran</th>
<th>Russia</th>
<th>Venezuela</th>
</tr>
</thead>
<tbody>
<tr>
<td>Speculative Grade</td>
<td>Speculative Grade</td>
<td>Speculative Grade</td>
<td>Investment Grade</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Political and Economic Risk</th>
<th>Iran</th>
<th>Russia</th>
<th>Venezuela</th>
</tr>
</thead>
<tbody>
<tr>
<td>Political and Economic Risk</td>
<td>High</td>
<td>High</td>
<td>High</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Score</th>
<th>Iran</th>
<th>Russia</th>
<th>Venezuela</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1.25 (L)</td>
<td>1.25 (L)</td>
<td>1.75 (L)</td>
</tr>
</tbody>
</table>

1206 Bahgat, “Russia’s Oil Potential: prospects and Implications,” p. 139.
Sources: For a full list of Moody’s, Standard & Poor’s and Fitch rankings country credit ratings see [http://entry.credit-suisse.ch](http://entry.credit-suisse.ch), [June 14, 2006]; for political and economic risk, see “2006 Political and Economic Risk,” *Oxford Analytica*, [http://www.aon.com/politicalrisk](http://www.aon.com/politicalrisk), [June 13, 2006]. Note: Higher the risk worse the credit rating, lower the score

11) Oil Scarcity Perception

Oil spare production capacity is a good indicator of general abundance or scarcity of oil. While in 1998 global oil spare production capacity stood at 8 percent of total oil demand, by 2005 it dropped to only 2 percent of world oil demand. Thus, it is not surprising that there are widespread perceptions of future oil scarcity and oil production peak, which in 2005 negatively affected IOCs’ bargaining power vis-à-vis Iran, Russia, and Venezuela.

<table>
<thead>
<tr>
<th>World Oil Production Spare Capacity</th>
<th>1998</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>8% of world oil demand</td>
<td>2% of world oil demand</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Peak Oil Perception</th>
<th>Iran</th>
<th>Russia</th>
<th>Venezuela</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>low</td>
<td>high</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Score</th>
<th>Iran</th>
<th>Russia</th>
<th>Venezuela</th>
</tr>
</thead>
<tbody>
<tr>
<td>Score</td>
<td>1.00 (L)</td>
<td>4.00 (VH)</td>
<td></td>
</tr>
</tbody>
</table>

Source: Leonidas P. Drollas, “The Oil Market – Key Questions,” Centre for Global Energy Studies, June 29, 2006, p. 4. Note: Higher the scarcity perception, higher the score

IOC Specific Resources

1) Reputation

Western IOCs had a positive reputation throughout the 1990s, and thus, they were invited to invest in Russia and Venezuela. This has not been the case in Iran, where American IOCs have not been welcome since the mid-1990s, and where country’s leaders and industry managers are essentially anti-Western, a legacy of the time of the consortia:

As an Iranian who went through nationalisation, revolution… my view of oil [is very shaped by those events]. I worked in the consortium and was astounded to find a “no Persian-speaking” sign in the managers’ mess. I saw that people were accomplishing their private business in the back field and I asked them why they were doing that. They said there were no toilets. There was no loo for workmen, who of course were all Iranian. So now, when outsiders say that “they will teach me something”…

Nowadays, it is important to note that reputation of IOCs, such as Exxon Mobil (see Chapter 3), which acted arrogantly in its bargaining with Russia and Venezuela, and Shell, which single-handedly and unsuccessfully managed Oman’s reservoirs, and over-stated its own worldwide reserves, is low. In addition, there exists a lack of trust in IOCs, particularly in OPEC countries such as Iran and Venezuela, countries historically exploited by these same companies. Thus, as illustrated above, many national oil experts in these countries exhibit a residual resentment of IOCs. It is common knowledge to IOCs that tapping into any of OPEC

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1208 An NIOC manager, quoted in Marcel, *Oil Titans*, p. 217.
1209 IOCs often overestimate what they have to offer and how valuable it is to the counterpart. In addition, they rarely consider NOCs as competitors. Marcel, “Investment in Middle East Oil: Who Needs Whom?” p. 4.
1210 Ibid, p. 3.
1211 Ibid.
countries’ natural resources is a very inflammatory subject. These factors negatively affect bargaining power of IOCs vis-à-vis host governments of Iran, Venezuela and Russia, particularly in the current decade, when these countries are lead by populist leaders.

<table>
<thead>
<tr>
<th></th>
<th>Iran</th>
<th>Russia</th>
<th>Venezuela</th>
</tr>
</thead>
<tbody>
<tr>
<td>Score</td>
<td>4.50 (VH)</td>
<td>4.50 (VH)</td>
<td>1.50 (L)</td>
</tr>
</tbody>
</table>

Note: Worse the IOCs’ reputation, higher the score

2) Availability of Local Allies

Even if IOCs had any local allies in Iran, Venezuela and Russia in 2005/06, these allies were unable to exert any influence over their respective leaders. Since autocratic leaders with overwhelming power at their disposal rule all three countries, any attempt to do so would have resulted in utter failure, most likely in imprisonment of local lobbyists, and in further deterioration of relations between the host government and IOCs. Local allies, such as the leadership of PdVSA (i.e. Luis Giusti) and some Russian oligarchs (i.e. Khodorkovsky) helped Western IOCs establish their presence in Venezuela and Russia, respectively, in the 1990s. Moderate Iranian President Khatami can be considered Western IOCs’ tacit ally, as he pushed for economic reform. However, by 2006, Western IOCs lost all their major local allies in all three countries. Hence, local lobbyists (if any) are nowadays not able to improve bargaining power of IOCs vis-à-vis autocratic governments of Iran, Russia and Venezuela.

<table>
<thead>
<tr>
<th></th>
<th>Iran</th>
<th>Russia</th>
<th>Venezuela</th>
</tr>
</thead>
<tbody>
<tr>
<td>Score</td>
<td>3.75 (VH)</td>
<td>4.00 (VH)</td>
<td>1.00 (L)</td>
</tr>
</tbody>
</table>

Note: Higher the availability, lower the score

3) Availability of Alternative Options

Nowadays, IOCs do not have alternative, equally or more attractive, options to pursue when bargaining with governments of Iran, Russia and Venezuela. Countries and “safe zones” that are open to IOC investment are those in which oil production has already peaked and production is costly (lower U.S. states, North Slope of Alaska, the Gulf of Mexico, North Sea); where IOCs’ presence is already established (U.S., U.K., Canada, Australia); where new production is possible only if oil prices remain at very high levels (Alberta); in areas where there are huge technical challenges and production is expensive (Siberia, Alberta, offshore West Africa); or in alternative energy sources (oil shale, natural gas). Many of these options are very risky, as they may become unprofitable if oil prices drop considerably in the future.

In addition, the IOCs are not welcome in the major oil-producing region of the world, the Middle East, and also in North Africa, Brazil and Mexico. If they are present in some countries in these regions, it is usually, as in Iran, under unfavourable terms. Similar to what is taking place in Russia and Venezuela, the IOCs are also struggling to maintain their presence in Kazakhstan, Ecuador, Bolivia, Chad and Nigeria. In addition, similar to Russia and Venezuela, Libya and the U.K. have made changes aimed at getting a bigger take of their oil resources. Analysts suggest that Angola, Africa’s fourth largest oil producer, will soon try to renegotiate some of its contracts

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1212 See Marcel, *Oil Titans*, pp. 42-3.
with IOCs. Africa, former Soviet Union, the Middle East and Latin America, regions in which IOCs most want to do business, are becoming increasingly difficult operating environments. All these factors reduce IOCs’ bargaining power vis-à-vis Iran, Russia and Venezuela, what is reflected below.

<table>
<thead>
<tr>
<th></th>
<th>1998</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Iran</td>
<td>Russia</td>
</tr>
<tr>
<td>Score</td>
<td>1.00 (L)</td>
<td>4.50 (VH)</td>
</tr>
</tbody>
</table>

Note: Higher the availability, lower the score

4) Reserve Replacement

In 1998, five major IOCs replaced more oil reserves than they produced in the year, and their reserves grew by 3.7 percent when compared to 1998. However, they did not manage to replace all of the oil produced in 2005, and thus, between 2004 and 2005 their reserves dropped by 9.5 percent. Thus, other things equal, while IOCs’ bargaining power vis-à-vis host states increased in 1998, it decreased considerably in 2005.

<table>
<thead>
<tr>
<th></th>
<th>1998</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Average for 5 Majors</td>
<td>Score</td>
</tr>
<tr>
<td></td>
<td>+3.7% (1.56 billion barrels)</td>
<td>Iran 1.75 (L)</td>
</tr>
<tr>
<td></td>
<td>-9.5% (-3.39 billion barrels)</td>
<td></td>
</tr>
</tbody>
</table>

Note: Higher the reserve replacement, lower the score

<table>
<thead>
<tr>
<th>IOC</th>
<th>Reserves (billion barrels)</th>
<th>Balance (2005-2004; billion barrels)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1997</td>
<td>1998</td>
</tr>
<tr>
<td>Exxon Mobil</td>
<td>10.895</td>
<td>11.550</td>
</tr>
<tr>
<td>BP Amoco</td>
<td>7.614</td>
<td>7.304</td>
</tr>
<tr>
<td>TotalFinaElf</td>
<td>5.905</td>
<td>6.267</td>
</tr>
<tr>
<td>Chevron</td>
<td>4.506</td>
<td>4.697</td>
</tr>
<tr>
<td>Texaco</td>
<td>3.267</td>
<td>3.573</td>
</tr>
<tr>
<td>Royal Dutch/Shell</td>
<td>9.681</td>
<td>10.031</td>
</tr>
<tr>
<td><strong>Total Majors</strong></td>
<td>41.866</td>
<td>43.422</td>
</tr>
</tbody>
</table>


<table>
<thead>
<tr>
<th>IOC</th>
<th>Reserves (billion barrels)</th>
<th>Balance (2005-2004; billion barrels)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2004</td>
<td>2005</td>
</tr>
<tr>
<td>Exxon Mobil</td>
<td>11.651</td>
<td>11.229</td>
</tr>
<tr>
<td>BP</td>
<td>7.550</td>
<td>7.161</td>
</tr>
<tr>
<td>Total</td>
<td>7.003</td>
<td>6.592</td>
</tr>
<tr>
<td>Chevron</td>
<td>5.511</td>
<td>3.626</td>
</tr>
<tr>
<td>Royal Dutch/Shell</td>
<td>3.745</td>
<td>3.466</td>
</tr>
<tr>
<td><strong>Total Majors</strong></td>
<td>35.460</td>
<td>32.074</td>
</tr>
</tbody>
</table>


Relative Variables

1) Capital Possession

Cash-rich IOCs seem like a perfect choice for host governments needy of foreign investment, and this was clearly the case in 1998, when one considers current account balances and foreign exchange reserves held by Iran, Russia, and Venezuela (see below). However, unlike in 1998, when oil prices stood at $14-15 a barrel, in 2005, with oil prices above $50 a barrel, evident in their positive current account balances and high foreign exchange reserves (see below), Russia, Venezuela and Iran could increasingly self-finance projects, as some of their investment capital was insulated from short-term government budgetary needs. In addition, Steffen Hertog argues, “current [high] oil prices generate surpluses with which governments can afford to buy any imaginable exploration and production service on the international market without yielding resource ownership.” Among Russia, Venezuela and Iran’s NOCs, NIOC was likely the only company, which was relatively capital-constrained because large funds were needed to support Iran’s non-oil economy, more so than in Russia or Venezuela. However, even if they are needy of extra capital, Russian, Iranian and Venezuelan NOCs can turn to developing countries’ NOCs or international financial institutions, rather than to IOCs, what gives them extra options in securing additional financial resources, if needed. Thus, IOCs’ increased capital possession (see below) carries little or no effect on their bargaining power vis-à-vis host governments.

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Current account balance</td>
<td>-$2.14 billion</td>
<td>$13.27 billion</td>
<td>$2.3 billion</td>
<td>$84.25 billion</td>
<td>-$4.43 billion</td>
<td>$25.36 billion</td>
</tr>
<tr>
<td>Foreign exchange reserves</td>
<td>$3.92 billion</td>
<td>$40.06 billion</td>
<td>$2.0 billion</td>
<td>$182.2 billion</td>
<td>$13.6 billion</td>
<td>$30.74 billion</td>
</tr>
<tr>
<td>Average for majors 6</td>
<td>$3.0 billion</td>
<td>$21.0 billion</td>
<td>$3.0 billion</td>
<td>$21.0 billion</td>
<td>$3.0 billion</td>
<td>$21.0 billion</td>
</tr>
<tr>
<td>Score</td>
<td>2.00 (M)</td>
<td>2.75 (M)</td>
<td>2.00 (M)</td>
<td>4.50 (VH)</td>
<td>2.50 (M)</td>
<td>3.00 (H)</td>
</tr>
</tbody>
</table>


<table>
<thead>
<tr>
<th>IOC</th>
<th>Profits</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1998</td>
</tr>
<tr>
<td>Exxon Mobil</td>
<td>$8.1 billion</td>
</tr>
<tr>
<td>Royal Dutch/Shell</td>
<td>$0.4 billion</td>
</tr>
<tr>
<td>BP</td>
<td>$4.6 billion</td>
</tr>
<tr>
<td>Total</td>
<td>$2.0 billion</td>
</tr>
<tr>
<td>Chevron</td>
<td>$1.9 billion</td>
</tr>
<tr>
<td>Conoco Phillips</td>
<td>$1.0 billion</td>
</tr>
<tr>
<td>Average</td>
<td>$3.0 billion</td>
</tr>
</tbody>
</table>


2) Technological Know-How

Despite a perception in many IOCs that most NOCs are technically incompetent, they have in fact honed specific skills that relate to geological characteristics of their reservoirs. Iran, for instance, although it generally possesses insufficient technological capability, has a concentration of carbonate reservoirs, and the constraints of these unusual reservoirs have allowed NIOC to develop specific expertise, which the company could in future apply elsewhere in the Middle East and the Caspian Sea area. Former Soviet Union and OPEC’s NOCs have kept their industry running with little or no help from the IOCs for the past 30 years, and while local technological knowledge in Russia, Iran and Venezuela may not be at the level of major IOCs, it is certainly not too much lower. For example, Russia is managing a remarkable production growth without major IOC involvement and its extractive capacities have strengthened in recent years, and Venezuela’s PDVSA has already in the 1980s been successful in selling oil production technology throughout Latin America and in the Middle East. Besides significant local technological expertise, Venezuela and Iran both managed to absorb some technological expertise from IOCs present there, since the IOCs usually “provide scientific and technical training, share know-how, introduce universal standards, and encourage local research and development.”

Future looks bright for NOCs, as some, NIOC for example, can tap into a large national pool of qualified engineers and have a competitive advantage over the IOCs, which are faced with a talent gap. Moreover, if the nuclear controversy leads to Iran’s total isolation from European and Japanese oil companies, then Tehran will increasingly turn to Chinese NOCs, supplement their investment capital with expertise from more technologically advanced Russian companies, and rely on government-to-government marketing deals. Additionally, in the current period of high oil prices, NOCs can purchase smaller, independent private oil companies in a drive to acquire the skills, the technology and the international exposure; they can buy advice from energy consultancy firms; sign limited contracts with service companies; or get help from other NOCs, and further increase their bargaining power.

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Score</td>
<td>1.50 (L)</td>
<td>2.00 (M)</td>
<td>1.50 (L)</td>
<td>1.75 (L)</td>
<td>2.25 (M)</td>
<td>1.75 (L)</td>
</tr>
</tbody>
</table>

Note: Higher the IOCs’ relative technological know-how, lower the score.

3) Managerial Skills

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1216 Marcel, *Oil Titans*, p. 73. Similarly, Sonatrach of Algeria has had long experience of exploring for oil under geologically challenging salt domes.

1217 Ahrend and Tompson, “Realising the Oil Supply Potential of the CIS,” p. 50.


1219 Imle, Jr., “Multinationals and the New World of Energy Development,” p. 269.

1220 Marcel, *Oil Titans*, p. 118.
While both in 1998/99 and in 2005/06, Western IOCs certainly possessed superior managerial expertise to that of state-owned companies of Russia, Venezuela, and Iran,\textsuperscript{1221} other things equal, this gave them a degree of bargaining advantage against the host states. However, in recent years, many international business consultancy firms offer professional managerial advice to the NOCs of Russia, Venezuela and Iran, in order to enhance the quality of their management skills. This in turn limits any bargaining advantage of the IOCs, which is still, however, higher than that of NOCs, particularly against Venezuela, since PdVSA lost many experienced managers when Chávez sacked 18,000 employees in 2002.

<table>
<thead>
<tr>
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<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Score</td>
<td>1.50 (L)</td>
<td>1.75 (L)</td>
<td>1.75 (L)</td>
<td>2.25 (M)</td>
<td>2.00 (M)</td>
<td>1.75 (L)</td>
</tr>
</tbody>
</table>

Note: Higher the IOCs’ relative managerial skills, lower the score

4) Access to Markets

Based on empirical evidence presented in case study chapters, although the Western IOCs were relatively important in providing markets for Iranian, Russian and particularly Venezuelan crude in the 1990s, these countries are not highly dependent on IOCs for market access in the current decade. Venezuela might be the only exception. Although it exports much of its crude to its own refineries in the United States, eight of which it owns fully or partially, and markets gasoline at 13,000 CITGO stations (to be reduced to 11,200), home countries of IOCs present in Venezuela, particularly the U.S., still take a major share of its oil and gas exports.\textsuperscript{1222} Their share is declining as China is becoming an increasingly important customer, and it is certain that the IOCs will not be responsible for transporting crude to China and accessing the Chinese market. As Iran exported larger share of its crude to Asia in 2005/06 than it did in 1998/99, IOCs do not play a major role in providing it with market access, but only a secondary role with its European markets. Needless to say, a similar scenario occurred in Russia. Through Transneft, Russia controls its pipelines out of the country, and additionally, is able to export much of its crude by using facilities and tankers of its own national and private companies, through which it has established downstream presence in much of Central and Eastern Europe, the Balkans, Western Europe and the United States in the recent years.\textsuperscript{1223} Hence, nowadays, since they provide only limited market access to Iran and Russia, IOCs do not gain any bargaining power vis-à-vis these countries, which is still not the case with Venezuela.

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Score</td>
<td>2.00 (M)</td>
<td>2.75 (M)</td>
<td>2.00 (M)</td>
<td>2.50 (M)</td>
<td>1.50 (L)</td>
<td>2.00 (M)</td>
</tr>
</tbody>
</table>

Note: Higher the IOCs’ relative access to markets, lower the score

Final Tables and Figures

The average scores for both 1998/99 and 2005/06 are averaged by dividing the total score for each host state with the number of variables (19). For all the scores, and overall and individual

\textsuperscript{1221} For more on Iran, see Marcel, \textit{Oil Titans}, p. 177.
variable differences between 1998/99 and 2005/06 scores for Iran, Russia, and Venezuela, please refer to the tables and figures below.

Table A8-1: The Total and Individual Variable Score for Iran, Russia, and Venezuela (1998/99 and 2005/06); and Table A8-2: The Overall Difference Between Host States’

<table>
<thead>
<tr>
<th>Variable</th>
<th>1998/99</th>
<th></th>
<th></th>
<th>2005/06</th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Iran</td>
<td>Russia</td>
<td>Russia</td>
<td>Iran</td>
<td>Russia</td>
<td>Russia</td>
<td>Russia</td>
</tr>
<tr>
<td>Reserve Size</td>
<td>4.25</td>
<td>3.75</td>
<td>4.25</td>
<td>4</td>
<td>4</td>
<td>4</td>
<td></td>
</tr>
<tr>
<td>Reserve Longevity</td>
<td>3.75</td>
<td>3.5</td>
<td>1.75</td>
<td>4.25</td>
<td>4</td>
<td>1.5</td>
<td></td>
</tr>
<tr>
<td>Potential Profitability</td>
<td>3.25</td>
<td>2</td>
<td>2.5</td>
<td>4.5</td>
<td>3.75</td>
<td>4</td>
<td></td>
</tr>
<tr>
<td>Economic Development</td>
<td>2.25</td>
<td>2.75</td>
<td>2</td>
<td>2.5</td>
<td>2</td>
<td>2.75</td>
<td></td>
</tr>
<tr>
<td>Barriers to Entry</td>
<td>3.5</td>
<td>1.25</td>
<td>1.75</td>
<td>4.25</td>
<td>4</td>
<td>4</td>
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</tr>
<tr>
<td>Strategic Importance</td>
<td>3.5</td>
<td>3.5</td>
<td>2.75</td>
<td>4.5</td>
<td>4.75</td>
<td>3.75</td>
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<tr>
<td>Cultural/Political Context</td>
<td>3.75</td>
<td>1.5</td>
<td>2.25</td>
<td>4.75</td>
<td>4.75</td>
<td>4.5</td>
<td></td>
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<tr>
<td>Competition</td>
<td>2.25</td>
<td>1.75</td>
<td>2</td>
<td>3.75</td>
<td>4.75</td>
<td>4.5</td>
<td></td>
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<tr>
<td>Political/Economic Risk</td>
<td>1.25</td>
<td>1.5</td>
<td>1.75</td>
<td>1.25</td>
<td>1.25</td>
<td>2</td>
<td></td>
</tr>
<tr>
<td>Oil Prices</td>
<td>1.5</td>
<td>1.5</td>
<td>1.5</td>
<td>4</td>
<td>4</td>
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<td>1</td>
<td>1</td>
<td>1</td>
<td>4</td>
<td>4</td>
<td>4</td>
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<tr>
<td><strong>Industry/Country Specific Subtotal</strong></td>
<td>30.25</td>
<td>24.25</td>
<td>23</td>
<td>42.25</td>
<td>41</td>
<td>39</td>
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<td><strong>Average</strong></td>
<td>2.75</td>
<td>2.20</td>
<td>2.09</td>
<td>3.84</td>
<td>3.73</td>
<td>3.55</td>
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<tr>
<td>Reputation</td>
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<td>1.5</td>
<td>4.5</td>
<td>4</td>
<td>3</td>
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<tr>
<td>Local Allies</td>
<td>3.75</td>
<td>1.5</td>
<td>1</td>
<td>4</td>
<td>3.75</td>
<td>3.5</td>
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<td>1</td>
<td>4.5</td>
<td>4.5</td>
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<tr>
<td>Reserve Replacement</td>
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<td>1.75</td>
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<tr>
<td><strong>IOC Specific Subtotal</strong></td>
<td>11</td>
<td>6.25</td>
<td>5.25</td>
<td>17</td>
<td>16.25</td>
<td>15</td>
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<tr>
<td><strong>Average</strong></td>
<td>2.75</td>
<td>1.56</td>
<td>1.31</td>
<td>4.25</td>
<td>4.06</td>
<td>3.75</td>
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<td>Capital Possession</td>
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<td>2</td>
<td>2.75</td>
<td>3</td>
<td>4.5</td>
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<tr>
<td>Technological Know-how</td>
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<td>1.5</td>
<td>2</td>
<td>1.75</td>
<td>1.75</td>
<td>2.25</td>
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<td>1.5</td>
<td>2</td>
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<td>1.75</td>
<td>1.75</td>
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<tr>
<td><strong>Relative Subtotal</strong></td>
<td>7</td>
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<td>8</td>
<td>9</td>
<td>8.5</td>
<td>11.5</td>
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<tr>
<td><strong>Average</strong></td>
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<td>1.88</td>
<td>1.94</td>
<td>2.25</td>
<td>2.13</td>
<td>2.88</td>
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<td><strong>TOTAL</strong></td>
<td>48.25</td>
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<td>36</td>
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<td>65.5</td>
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<td><strong>AVERAGE</strong></td>
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<td>1.89</td>
<td>3.59</td>
<td>3.46</td>
<td>3.45</td>
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</table>

Bargaining Power vis-à-vis IOCs’ (1998/99 and 2005/06; Average for Iran, Russia, and Venezuela)
Figure A8-1: Relative Bargaining Power between Iran and IOCs (Individual Variables; 1998/99 and 2005/06)

<table>
<thead>
<tr>
<th>Variable</th>
<th>1998/99</th>
<th>2005/06</th>
<th>Difference</th>
</tr>
</thead>
<tbody>
<tr>
<td>HS Reserve Size</td>
<td>4.00</td>
<td>4.17</td>
<td>0.17</td>
</tr>
<tr>
<td>HS Reserve Longevity</td>
<td>3.00</td>
<td>3.25</td>
<td>0.25</td>
</tr>
<tr>
<td>HS Production Profitability</td>
<td>2.58</td>
<td>4.08</td>
<td>1.50</td>
</tr>
<tr>
<td>HS Economic Development</td>
<td>2.33</td>
<td>2.42</td>
<td>0.08</td>
</tr>
<tr>
<td>HS Barriers to Entry</td>
<td>2.17</td>
<td>4.08</td>
<td>1.92</td>
</tr>
<tr>
<td>HS Strategic Importance of Oil</td>
<td>3.25</td>
<td>4.33</td>
<td>1.08</td>
</tr>
<tr>
<td>HS Cultural/Political Context</td>
<td>2.50</td>
<td>4.67</td>
<td>2.17</td>
</tr>
<tr>
<td>HS Competition</td>
<td>2.00</td>
<td>4.25</td>
<td>2.25</td>
</tr>
<tr>
<td>HS Political/Economic Risk</td>
<td>1.50</td>
<td>1.50</td>
<td>0.00</td>
</tr>
<tr>
<td>Oil Prices</td>
<td>1.50</td>
<td>4.00</td>
<td>2.50</td>
</tr>
<tr>
<td>Oil Scarcity Perception</td>
<td>1.00</td>
<td>4.00</td>
<td>3.00</td>
</tr>
<tr>
<td>IOC Reputation</td>
<td>2.67</td>
<td>3.83</td>
<td>1.17</td>
</tr>
<tr>
<td>IOC Local Allies</td>
<td>2.08</td>
<td>3.75</td>
<td>1.67</td>
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<tr>
<td>IOC Alternative Options</td>
<td>1.00</td>
<td>4.50</td>
<td>3.50</td>
</tr>
<tr>
<td>IOC Reserve Replacement</td>
<td>1.75</td>
<td>4.00</td>
<td>2.25</td>
</tr>
<tr>
<td>Relative Capital Possession</td>
<td>2.17</td>
<td>3.42</td>
<td>1.25</td>
</tr>
<tr>
<td>Relative Technological Know-how</td>
<td>1.67</td>
<td>1.92</td>
<td>0.25</td>
</tr>
<tr>
<td>Relative Managerial Skills</td>
<td>1.75</td>
<td>1.92</td>
<td>0.17</td>
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<tr>
<td>Relative Market Access</td>
<td>1.83</td>
<td>2.42</td>
<td>0.58</td>
</tr>
<tr>
<td>Overall Average</td>
<td>2.14</td>
<td>3.50</td>
<td>1.36</td>
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Figure A8-2: Relative Bargaining Power between Venezuela and IOCs (Individual Variables; 1998/99 and 2005/06)

Figure A8-3: Relative Bargaining Power between Russia and IOCs (Individual Variables; 1998/99 and 2005/06)
## APPENDIX 9: Acronyms and Abbreviations

<table>
<thead>
<tr>
<th>Acronym</th>
<th>Description</th>
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<tbody>
<tr>
<td>ADNOC</td>
<td>Abu Dhabi National Oil Company</td>
</tr>
<tr>
<td>AIIOC</td>
<td>Anglo-Iranian Oil Company</td>
</tr>
<tr>
<td>ANILCA</td>
<td>Alaska National Interest Lands Conservation Act</td>
</tr>
<tr>
<td>ANWR</td>
<td>Arctic National Wildlife Refuge</td>
</tr>
<tr>
<td>Aramco</td>
<td>Arabian American Oil Company</td>
</tr>
<tr>
<td>BBC</td>
<td>British Broadcasting Corporation</td>
</tr>
<tr>
<td>BFG</td>
<td>Baikal Finance Group</td>
</tr>
<tr>
<td>BP</td>
<td>British Petroleum</td>
</tr>
<tr>
<td>bpd</td>
<td>barrels per day</td>
</tr>
<tr>
<td>BTC</td>
<td>Baku-Tbilisi-Ceyhan</td>
</tr>
<tr>
<td>CAFE</td>
<td>Corporate Average Fuel Economy</td>
</tr>
<tr>
<td>CCP</td>
<td>Chinese Communist Party</td>
</tr>
<tr>
<td>CEO</td>
<td>Chief Executive Officer</td>
</tr>
<tr>
<td>CERA</td>
<td>Cambridge Energy Research Associates</td>
</tr>
<tr>
<td>CFR</td>
<td>Council on Foreign Relations (US)</td>
</tr>
<tr>
<td>CIA</td>
<td>Central Intelligence Agency (US)</td>
</tr>
<tr>
<td>CIS</td>
<td>Commonwealth of Independent States</td>
</tr>
<tr>
<td>CNOCs</td>
<td>consumers’ national oil companies</td>
</tr>
<tr>
<td>CNOOC</td>
<td>China National Offshore Oil Corporation</td>
</tr>
<tr>
<td>CNPC/PetroChina</td>
<td>China National Petroleum Corporation</td>
</tr>
<tr>
<td>COG</td>
<td>Chief of Government</td>
</tr>
<tr>
<td>CSIS</td>
<td>Center for Strategic and International Studies</td>
</tr>
<tr>
<td>CSR</td>
<td>corporate social responsibility</td>
</tr>
<tr>
<td>CVP</td>
<td>Corporación Venezolana de Petróleo</td>
</tr>
<tr>
<td>DOE</td>
<td>Department of Energy (US)</td>
</tr>
<tr>
<td>EIA</td>
<td>Energy Information Administration (US)</td>
</tr>
<tr>
<td>ENI</td>
<td>Ente Nazionale Idrocarburi (Italian oil company)</td>
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<tr>
<td>EOR</td>
<td>enhanced oil recovery</td>
</tr>
<tr>
<td>EU</td>
<td>European Union</td>
</tr>
<tr>
<td>FCO</td>
<td>Foreign and Commonwealth Office (UK)</td>
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<tr>
<td>FDI</td>
<td>Foreign Direct Investment</td>
</tr>
<tr>
<td>FIRA</td>
<td>Foreign Investment Review Agency (Canada)</td>
</tr>
<tr>
<td>GAO</td>
<td>Government Accountability Office (US)</td>
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<tr>
<td>GATT</td>
<td>General Agreement on Tariffs and Trade</td>
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<tr>
<td>GDP</td>
<td>Gross Domestic Product</td>
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<tr>
<td>HR</td>
<td>House Resolution (US)</td>
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<tr>
<td>IAEA</td>
<td>International Atomic Energy Agency</td>
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<td>IBS</td>
<td>International Business Studies</td>
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<td>IEA</td>
<td>International Energy Agency</td>
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<tr>
<td>ILSA</td>
<td>Iran and Libya Sanctions Act</td>
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<td>IMF</td>
<td>International Monetary Fund</td>
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<tr>
<td>INOC</td>
<td>Iraq National Oil Company</td>
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<td>IOB</td>
<td>Iranian Oil Bourse</td>
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<tr>
<td>IOC</td>
<td>international oil company</td>
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<tr>
<td>IOCorp</td>
<td>Indian Oil Company</td>
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<td>IPE</td>
<td>International Political Economy</td>
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<tr>
<td>IR</td>
<td>International Relations</td>
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<tr>
<td>JV</td>
<td>joint venture</td>
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<td>Abbreviation</td>
<td>Full Form</td>
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<tr>
<td>kbpd</td>
<td>thousand barrels per day</td>
</tr>
<tr>
<td>KPC</td>
<td>Kuwait Petroleum Corporation</td>
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<tr>
<td>mbpd</td>
<td>million barrels per day</td>
</tr>
<tr>
<td>MEP</td>
<td>Ministry of Energy and Petroleum (Venezuela)</td>
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<tr>
<td>MIT</td>
<td>Massachusetts Institute of Technology</td>
</tr>
<tr>
<td>MITI</td>
<td>Ministry of International Trade and Industry (Japan)</td>
</tr>
<tr>
<td>MNC</td>
<td>multinational company</td>
</tr>
<tr>
<td>MNE</td>
<td>multinational enterprise</td>
</tr>
<tr>
<td>MOIP</td>
<td>Mandatory Oil Import Program</td>
</tr>
<tr>
<td>MoP</td>
<td>Ministry of Petroleum (Iran)</td>
</tr>
<tr>
<td>MP</td>
<td>member of parliament</td>
</tr>
<tr>
<td>NAFTA</td>
<td>North American Free Trade Agreement</td>
</tr>
<tr>
<td>NDRC</td>
<td>National Development Reform Commission (China)</td>
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<tr>
<td>NEP</td>
<td>National Energy Policy (US; Canada)</td>
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<tr>
<td>NEPD</td>
<td>National Energy Policy Development (US)</td>
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<tr>
<td>NGL</td>
<td>natural gas liquids</td>
</tr>
<tr>
<td>NIOC</td>
<td>National Iranian Oil Company</td>
</tr>
<tr>
<td>NNPC</td>
<td>Nigerian National Petroleum Corporation</td>
</tr>
<tr>
<td>NOC</td>
<td>national oil company</td>
</tr>
<tr>
<td>NPT</td>
<td>Nuclear Non-Proliferation Treaty</td>
</tr>
<tr>
<td>NRDC</td>
<td>National Resources Defense Council (US)</td>
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<tr>
<td>OAPEC</td>
<td>Organization of Arab Petroleum Exporting Countries</td>
</tr>
<tr>
<td>OBM</td>
<td>obsolescing bargain model</td>
</tr>
<tr>
<td>OECD</td>
<td>Organization of Economic Cooperation and Development</td>
</tr>
<tr>
<td>ONGC</td>
<td>Oil and Natural Gas Corporation</td>
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<td>OPEC</td>
<td>Organization of Petroleum Exporting Countries</td>
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<td>PBM</td>
<td>political bargaining model</td>
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<tr>
<td>PdVSA</td>
<td>Petróleos de Venezuela S.A. (Venezuelan NOC)</td>
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<td>PEMEX</td>
<td>Petróleos Mexicanos (Mexican NOC)</td>
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<td>Pertamina</td>
<td>Perusahaan Tambang Minyak Negara (Indonesian NOC)</td>
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<td>Petrobras</td>
<td>Petróleo Brasileiro (Brazilian oil company)</td>
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<td>Petronas</td>
<td>Petroleam Nasional Berhad (Malaysian NOC)</td>
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<td>PNOCs</td>
<td>producers’ national oil companies</td>
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<td>PPC</td>
<td>petro-political cycle</td>
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<tr>
<td>PPP</td>
<td>Purchasing Power Parity</td>
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<tr>
<td>PRC</td>
<td>People’s Republic of China</td>
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<tr>
<td>PSA</td>
<td>Production Sharing Agreement</td>
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<tr>
<td>R/P</td>
<td>reserves/production</td>
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<tr>
<td>R/T</td>
<td>royalty/tax</td>
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<tr>
<td>RSA</td>
<td>risk service agreement</td>
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<tr>
<td>S&amp;P</td>
<td>Standard and Poor’s</td>
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<tr>
<td>SCO</td>
<td>Shanghai Cooperation Organization</td>
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<tr>
<td>SDF</td>
<td>Self-Defense Forces (Japan)</td>
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<tr>
<td>SEO</td>
<td>State Energy Office (China)</td>
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<tr>
<td>SETC</td>
<td>State Economic and Trade Commission (China)</td>
</tr>
<tr>
<td>SingTel</td>
<td>Singapore Telecom</td>
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<tr>
<td>Sinopec</td>
<td>China National Petrochemical Corporation</td>
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<tr>
<td>SPR</td>
<td>Strategic Petroleum Reserve (US)</td>
</tr>
<tr>
<td>SST</td>
<td>supersonic transport</td>
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<td>Abbreviation</td>
<td>Full Form</td>
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<tr>
<td>SUV</td>
<td>sport-utility vehicle</td>
</tr>
<tr>
<td>TAPS</td>
<td>Trans-Alaska Pipeline System</td>
</tr>
<tr>
<td>TNC</td>
<td>transnational corporation</td>
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<tr>
<td>TNK</td>
<td>Tyumen Oil (Russian oil company)</td>
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<tr>
<td>TNK-BP</td>
<td>Tyumen Oil-British Petroleum</td>
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<tr>
<td>UAE</td>
<td>United Arab Emirates</td>
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<tr>
<td>UK</td>
<td>United Kingdom</td>
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<tr>
<td>UN</td>
<td>United Nations</td>
</tr>
<tr>
<td>UNCRET</td>
<td>United Nations Centre for Natural Resources, Energy and Transport</td>
</tr>
<tr>
<td>UNESCO</td>
<td>United Nations Educational, Scientific and Cultural Organization</td>
</tr>
<tr>
<td>UFG</td>
<td>United Financial Group</td>
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<tr>
<td>UNOCAL</td>
<td>Union Oil Company of California</td>
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<td>US</td>
<td>United States</td>
</tr>
<tr>
<td>USGS</td>
<td>United States Geological Survey</td>
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<tr>
<td>USSR</td>
<td>Union of Soviet Socialist Republics</td>
</tr>
<tr>
<td>VER</td>
<td>voluntary export restraint</td>
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<tr>
<td>WMD</td>
<td>weapons of mass destruction</td>
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<tr>
<td>WTI</td>
<td>West Texas Intermediate</td>
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<tr>
<td>WTO</td>
<td>World Trade Organization</td>
</tr>
<tr>
<td>YPFB</td>
<td>Yacimientos Petrolíferos Fiscales Bolivianos (Bolivian NOC)</td>
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