The feasibility of establishing international energy-trading norms. A framework for a deeper analysis and proposals

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When energy trade is the matter of concern, oil comes immediately to mind, given its presence as a global commodity, its strategic connotations, the geographic distribution of reserves, and its place in international economic relations. Petroleum is indeed the largest traded commodity, both in terms of volume and value. But international energy trade can no longer be limited to oil or other fossil fuels: new energy sources, technologies and services are increasingly present in international exchanges and new markets have also emerged, some of them related to energy and environment issues. International energy-trading norms must cover more complex issues, at a time when the world economy is concerned by the expanding consumption of fossil fuels, its environmental impact, security and geopolitical issues, and the need to realize an energy transition.

We have to think about the feasibility of new international energy trading norms in this complex framework. In this paper we raise critical and emerging issues and questions, as a basis for discussion and deeper reflection. We shall take, as examples, problems posed by the integration of oil in the multilateral process of WTO and the emergence of new markets related with energy and its environment impacts.

Before going further in the study of these two points, the present context is introduced.

1 – Free trade and re-emergence of protectionism

Since the mid-eighties there has been a proliferation of free trade agreements, however currently we witness to a rebirth of protectionism, sometimes articulated around existing regional commercial blocs. Till recently, regional free trade agreements were considered the best engines of integration, in the avant-garde of multilateral agreements. However, now voices are heard that consider them inconsistent with one another and contradictory with multilateral initiatives. Will the present crisis encourage a new tide of protectionism around the existing commercial blocs? There is evidence to suggest the growth of intra-regional trade, which is accompanied by negative effects on countries, which do not belong to these blocks.

In Europe protectionism is promoted as a legitimate way to defend vital industries and markets. If economic patriotism becomes the rule at the global level, it should at least be European. In another context, many civil society organizations in NAFTA (North American Free trade Agreement) countries are not convinced that a more intense and open international trade is directly linked with an increasing well being, economic growth and job creation. Are trends moving in a direction contrary to free trade? As history demonstrate, trends favorable to free markets and globalization could be reversed.

In this context, is there an “energy exception”? In Europe, there is no consensus yet on yielding full responsibility for the security of energy supply to market dynamics. With the exception of Great Britain, publicly administered markets prevail, which are characteristically dominated by big national enterprises and weakly interconnected. Besides, regulated prices impede the entry of new players, in spite of European directives in favor of the liberalization of electricity (1996) and gas (1998). Moreover,

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access to international pipelines is difficult: transit is free but often enterprises are opposed to the transportation of gas, excepted for their clients.

In the case of North America, the US pushes regularly in favor of a "continental energy policy" with full free movements of goods and energy services and complete accessibility to resources. This implies removing all obstacles to E&P, production and transport; supporting action of private enterprises; establishing favorable institutional frameworks and securing energy supply through the market, political cooperation or other means. However, the US designs, pressures and demands confront different restrictions from its partner. If energy trade between USA and Canada is driven by market and private enterprises strategies, there are also interconnected infrastructures that have created an energy symbiosis, both in economic and physical terms between these two countries. Nevertheless, there is increasing awareness that Canada, since the Free Trade Agreement with the US, which was reinforced by NAFTA, does not have a coherent legal framework for its own energy security. Canada could not, for example, reduce exports in order to give priority to internal needs. There are also new worries concerning energy reserves and the dominance of foreign investments, mainly US, in the energy sector. A former Canadian Ambassador in Mexico summarized these difficulties as follows: "to integrate free trade in the energy sector is a very delicate question"[1].

In South America, the liberal integration of the 90s (trade and financial liberalization, state withdrawing) has progressively given way to trends toward state-led integration (economic nationalism, voluntary integration, south-south relations). We are further witnessing a comeback of the state in the energy sector itself. This takes any shapes, including: «reforming the reforms», price controls, revision of fiscal regimes and of contracts and possibly canceling the current disputes settlement mechanisms through international institutions, such as the International Centre for Settlement of Investment Disputes. New terms appear in the literature that try to reflect these new situations: "resource nationalism", "full oil sovereignty" etc. However, it would be an exaggeration to state that international economic power is shifting towards resource-rich countries. Developed countries, since the shocks of the seventies are better equipped to face critical situations; they control technologies and product markets, as well as energy equipments, international financial institutions, etc.

2 – Oil, OPEC and WTO

Availability and affordability of oil is of primary concern. At present, "market-related prices" (R. Mabro[2]) prevail. Moreover, there are new financial markets and speculative actors, financial institutions with sophisticated knowledge and strategies, and oil companies that make enormous profits from their trading activities. Financial markets do not depend from OPEC, the main culprit historically responsible for high oil prices. Flows in and out of futures markets are often not related with physical oil flows, and are not controlled by oil producers, which cause economically perturbing fluctuations. If we are interested in energy trading norms, we have to look at current efforts aimed at establishing new global financial market regulation, following the recent crisis.

According to some specialists, problems will be solved if a competitive oil market is developed, with limited government intervention (regulation, transparency). Such a market would determine the prices of goods and direct investment to renewable

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[1] Notas de Gaëtan Lavertu, embajador de Canadá en México, sobre "La integración energética en América del Norte", México, 21 de enero del 2004.

[2] "Robert Mabro questions the suitability of the current oil price regime", *Oxford Energy Forum,* issue 68, February 2007.

energies, reduce expensive strategic reserves, maintain commercial stocks at adequate levels and reduce the price volatility stimulated by political decisions. A competitive global oil market would need, obviously, the dissolution of OPEC, because this organization operates on grounds, which are contrary to the principles of free trade. This dissolution is not a theoretical hypothesis. Indeed, the Doha declaration has inscribed in the negotiations agenda the dismantling of state cartels. Besides, the project directed to revise article XI, which is concerned with quantitative trade restrictions, is clearly aimed at OPEC quotas.

Clearly, there are contradictions between the WTO and OPEC, but both organizations are indispensable. Thus, OPEC is often seen as having a "pivotal role" in the regulation of petroleum supplies and prices and WTO as an organization that remains the "centre of gravity" of the multilateral trade regime. There are also intervening political and geopolitical factors: three important OPEC members, Iraq, Iran and Libya, are not WTO members (the application of Iran and Libya was blocked by the US) and Saudi Arabia could not conclude its accession negotiations.

Multilateral agreements have been so far mostly focused on manufactured products. The issue of whether the multilateral trading system can integrate oil and establish an interface between OPEC and WTO has never been seriously considered, but there are some interesting literature and research projects reflecting on this pertinent question[3]. In any case, the role of that multilateral system would not be complete if it did not cover such a crucial commodity as oil. However, since WTO is a *member-driven organization*, and the negotiation agenda and its scope are controlled by member countries, there is no guarantee that there will be a consensus in order to incorporate oil in the multilateral norm.

In principle WTO rules apply equally to energy products. However, these rules consider mainly import barriers, when trade restrictions in the energy sector are rather export barriers, especially due to the decisions of oil exporting countries. Those countries consider energy as an important input for development: consequently, they often take measures contrary to WTO principles. Thus OPEC actions, which often consist in quantitative export restrictions, mainly aim at deriving income from their natural resources and contributing to the determination of "adequate and stable" oil prices.. WTO is also concerned by the dual-pricing practices of exporting countries, and the resulting subsidies, procurement in the energy sector, and export taxes. On the other hand, OPEC is concerned by high internal taxes on petroleum products or the development of renewable sources of energy by consumer countries. This organization would also be interested in issues such as market access of downstream products and the access to market of energy services of WTO Members, among others. However, both WTO and OPEC agree on the importance of investments to build energy transportation networks and to expand production capacities. The energy sector, indeed, is capital-intensive and requires huge investments. A problem arises for producer countries when TRIMs Agreement prohibits measures such as local content requirements. It is indeed prohibited to impose investment measures that require companies to buy a certain amount of goods of national origin or condition certain imports on the amount of exports.

The treatment of oil in the WTO framework has never been a serious issue in the producer/consumer dialogue, even if there is common ground to advance in this direction. In particular, OPEC approves "a fair agreement" that recognizes owners' rights to a just price for their non-renewable resources and reassurance of their

[3] See: Melaku Geboye Desta, "OPEC And The WTO: Petroleum As A Fuel For Cooperation In International Relations", *Middle East Economic Survey*, VOL. XLVII, No 10, March 8, 2004.

sovereign right to their natural resources and, on the other side, consumers' rights to a guaranteed oil supply at reasonable prices.

There are now other forums, such as the newly International Energy Forum, in charge of a global dialogue on energy. It cannot ignore that, according to the IEA, the global demand for oil is expected to increase from the present level of 85 million b/d to 116 mb/d by 2030. Although, with their large oil reserves some OPEC countries will contribute to meet such exceptional demand, oil consumer countries must be prepared to negotiate future oil supplies. This raises important questions: on what terms and conditions? At what prices? Which actors will undertake future investment in the international oil industry? What consequences could be expected if major oil consuming countries decide to tax certain oil products?

2 – Trade issues in the context of renewable energies and environment

Some specialists consider that present "market-related prices" can allow the delivery of oil in quantities needed to current demand requirements; but at the same time there is a perception, widely shared, concerning the physical limits of fossil energy (depletion, peak oil, ….). This leads important actors to take actions to ensure access to energy resources, a situation that could aggravate geopolitical conflicts. China is often mentioned in this context, although US and European oil consumption has increased annually for the last two decades, in spite of fiscal, regulatory and different exhortations to moderate that trend. Moreover, worldwide, as mentioned above, global demand for energy would increase. Implications of these trends are well known and include: climbing energy prices, a fuel mix dominated by fossil energy for many decades, huge investment needs, pollution and energy security.

Despite increasing environmental concerns, more research is needed to analyze in detail the interactions between energy, international trade and environment issues[4]. What role could the multilateral trading system play in the fight against global warming? This is a decisive question since fossil energy is the main source of energy trade but also of greenhouse gases (GHG). Governments, faced with obligations to reduce emissions, are currently take actions that may be contrary to international trading norms, specifically contrary to WTO process, such as subsidization, green energy taxation and new energy standards.

Measures are also taken toward the reduction of environmental impacts through the emergence of a new market that pretends to become global, that of carbon trading (*emissions trading and trading in project-based credits*). In fact, the Kyoto protocol has a more ambitious objective: i.e. the administration of public environmental goods through market mechanisms and the emergence of new forms of property rights. Interestingly, this approach began in the US, where governments, academics, environmentalists, UN agencies and corporations worked together to develop a market approach to climate change mitigation. A lesson from this experience is that, where needed, the organization of a market requires the intervention of states and multiple actors, and complementary measures at different levels. Perhaps this is a way to overcome the debate on regulatory and control measures as opposed to market oriented instruments. Markets are not a pure economic construction, but predominantly a social construction. The EU Emissions Trading Scheme (2005) is a good example of this: it has come in line with the broad backing from Non Governmental Organizations.

Considering renewable energies, one should also mention the emerging biofuels market. The US is supporting domestic biofuels as a way to reduce oil dependence, but

[4] See CEPMLP (University of Dundee) research projects in this field.

also to promote rural development in the Middle West. Brazil is emerging in the world market as the biggest biofuels producer with the most favorable conditions. This country considers protectionism unacceptable in the case of renewable fuels and fights in favor of international free market for biofuels and for the conversion of ethanol into a basic world "commodity". It stands particularly against tax imports, tariffs and subsidies as those established in the US for domestic maize and is favorable to enlist ethanol as an environmental good, which would benefit from tax free imports. In this perspective, Brazilian producers consider that policies to encourage demand are not akin to subventions, but necessary for the creation of a new market that will be instrumental in the desired environment and energy transition away from fossil fuels.

Final considerations

During the 90´s explicit policies modified the "mix between authority and market" (Susan Strange), by proposing the generalized adoption of markets as mechanisms of coordination, these having even precedence over states. In today's world economy, markets seem to prevail, especially the financial ones. This evolution implies a radical change for the role of the states and of international institutions that support a more administered concept of international regulation. The US position has been, precisely, to remove most of regulatory prerogatives from states and international organizations and favor market actions.

Energy matters involve political and geopolitical implications, beyond building a mere economic transactions field. However, there has also been an assertion of the role of markets as a means of dominant regulation in the energy scene. Certain states and even international organizations look now for margins of maneuver, for instance to define the rules on which market activities should take place. At international level, however, some states are more powerful than others - whether in the relational or structural sense - and can intervene or impose rules to make those markets work for their own benefit. For these countries, namely the US, energy could be perceived as essential for its national security and can hinder new energy-trading initiatives.

More than any other sectors, the energy business of the coming years will be shaped by the interactions between environmental regulation, technological advancement, the investment patterns of energy companies and the role of international financial institutions. Oil exporting countries must accept the fact that new issues, like climate change, will influence energy trade and actors' strategies in international energy scene. Rather than resist or be left aside in the process, they have to become active and constructive partners, join the debate, and try to influence the formulation of policies and of worldwide implementation of climate change mitigation initiatives.