Transnational anew, competitive at last: The oil market in the globalisation era

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1. An international political economy approach to oil market

In a seminal article published in 1970[1], Susan Strange deplored the 'mutual neglect' between international economics and the study of international relations by political scientists. Years of observation of the world economy had convinced her that the growing compartmentalisation of the social sciences was condemning them all "to building intellectual houses of cards", and preventing advances in the understanding of the international phenomena under study. For some, the international arena was being reduced to the dialectics of war and peace between nation states, with every other form of relations — including economic ones — being ultimately reduced to these dialectics. As for economists, they were constantly increasing understanding of a market of which they were making such an abstract representation that the growing sophistication of the models was distancing them from reality more than it was bringing them closer to it. At that time, Strange (with a few others) was calling for the development of conceptual tools deriving from political analysis to consider the world economy. International political economy would then be conceived as the study of the interaction between:

- On the one hand, the confrontation of state sovereignties, whose regulation is primarily a question of power and secondarily of norms and institutionalised procedures; this confrontation is shifting to the economic arena, as states' objective changes from *survival and/or territorial extension* to the *attraction of a maximum of economic growth on their populations* in a context of globalization*;*

- On the other hand, global economic activity (production and exchanges), which is a process of strategic interaction and not one of "blind" optimisation behaviours, and which develops in a context *structured by the exercise of power*.

This definition is not at all consensual. It would be disputed by many for the dominant role acknowledged to power at the expense of institutional dimensions[2], and by

1. S. Strange, 'International Economics and International Relations: A Case of Mutual Neglect', *International Affairs*, (Vol. 46, No. 2, April 1970), pp. 304-315.

2. On the debate between neo-realism and liberal institutionalism in international relations, see David Baldwin, 'Neoliberalism, Neorealism, and World Politics' in Baldwin (ed.), *Neorealism and Neoliberalism: The Contemporary Debate* (N.Y., Columbia University Press, 1993), pp. 3-25.

others for the affirmation that the economy *is* by nature an arena in which power is exercised — which is explicitly denied by the neo-classical concept of the market, provided the latter is competitive. But this is not the place to go more deeply into this theoretical discussion.

The problem consists then in understanding how these two components are linked, influence over each other, support or conflict with each other in the global oil system. To consider oil in terms of International Political Economy (IPE), is thus to see it *simultaneously* as a potential object of inter-state confrontation and of economic competition.

2. World oil between inter-state struggle and transnational forces

The history of oil shows an alternation between periods when the structuring of the sector seems exogenous to inter-state confrontation — it is then essentially the act of the invisible hand of market mechanisms and/or of the very visible hand of the big oil companies — and periods when these actors and transnational mechanisms only operate within the structuring of the oil scene by the most powerful states. Less schematically, it could be said that the degree of transnationalisation of the oil sector has fluctuated according to changes in the international system, the interests of the great powers, and market conditions. The industry experienced a period of essentially transnational regulation from 1930 to 1970. But the involvement of the great powers has grown from the end of the second World War, and in particular from the 1960s onwards, within a context of domination of the market by a group of highly organised and very powerful companies. From the early internationalisation of the oil industry, the transnational firms (TNFs) have structured the global oil environment in their best interests[3]. Later in the century, the states they were highly dependent and that transnational practices were becoming structurally unfavourable to certain interests deemed important by the state apparatuses; in the 1960s this awareness materialised in policy initiatives.

Some of the major importing countries (in particular France, Italy and Japan), considering their supplies to be too dependent on firms in the cartel, created national companies and gave them a special status (more or less monopolistic) by legislation. The resources-rich countries, becoming aware of the gap between the operating conditions of the transnational firms and the potential revenue represented by their oil wealth, claimed and obtain more favourable rules of the game. From the 1950s, the United States

[3]. On this aspect, see the historical study by Gregory Nowell, and his concept of 'transnational structuring': *Mercantile States and the World Oil Cartel, 1900-1939*, (Ithaca and London, Cornell U.P., 1994).

Congress tried to carry out actions against the international oil cartel whose existence and methods of operation, which were contrary to the spirit of American antitrust legislation, were deemed harmful to the economic well-being of the country.[4] In its efforts, it came into conflict with the vision of the American executive power, which, in the conduct of its oil policy, was subordinating the observance of liberal principles to the pursuit of wider foreign policy objectives.[5]

This change led to a split in the 1970s. The take-over of the management and control of reserves and production by OPEC member states, preceded by negotiations with the transnational firms in which the latter appeared to be in a position of weakness, and which resulted in the nationalisation of the downstream assets of the TNFs, was a stark reinforcement of direct state action in the oil game. The price rises which accompanied this "revolution" revealed to the developed countries their great vulnerability to OPEC member countries, introducing a direct inter-state dimension to international oil relations. The development of inter-governmental negotiations and contracts is one of the tangible expressions of this historical rupture. The position of the TNFs deteriorated strongly, as they lost their direct access to the bulk of world reserves, control of which constituted the basis of their power and profits. They then took advantage of the enormous profits generated by the rise in prices to invest massively in politically safer areas (the North Sea, Alaska, the Gulf of Mexico) but also had to confront major downstream over-capacity resulting from the fall in consumption. In sum, "At the beginning of the 1980's, oil began to resemble a sector in decline, in which the very survival of some companies was in question.".[6]

The oil configuration which prevailed at the end of the 1970s could no longer be described as transnational in the same way as the order dominated by the majors until 1970-72: on one hand, states were direct actors in the oil business at both ends of the chain; on the other, the share of world oil produced by TNFs was shrinking (production in 1972 outside the United States by the large integrated companies was 5 times its 1982 level, and twice their oil production throughout the world at the beginning of the 1980s[7]). The TNFs had became purchasers of crude from the national companies of their

[4]. See the famous Senate reports on the oil cartel, in particular *The International Petroleum Cartel* (1952) or the very explicit *US vs. Standard Oil Company* (US District Government, Southern District of N.Y., 1961). The book by J. Blair, *The Control of Oil* (N.Y., Pantheon Books, 1976), has popularised the idea of the existence and maintenance of the oil cartel as contrary to the interests of American consumers and to the economic well-being of the country.

[5]. This point is made in the study by S. Krasner, *Defending the National Interest. Raw Material Investments and U.S. Foreign Policy*, (Princeton, N.J., Princeton U.P., 1978), pp. 330-331.

[6]. Peter Odell, 'International Oil: A Return to American Hegemony', *The World Today* (November 1994), p. 209.

[7]. Cf. J. Hartshorn, *Oil Trade: Politics and Prospects* (Cambridge, C.U.P., 1993), p. 115 and Hartshorn, 'Government Sellers in a Restructured Crude Oil Market', *in* D. Hawdon (ed.), *The Changing Structure of the World Oil Industry* (London, Croom Helm, 1985), p. 60.

former host countries. It should be noted however that the firms did not lose all power and remained major players in the sector (in particular, they retained control over most of the world downstream oil industry). Similarly, their power as transnational players did not disappear either, as shown by the negotiations with states on the tax systems applicable in the new areas, especially the North Sea. By and large, however, the transnationals would now have to live and work in a context structured at the level of interstate relations.[8]

This reality appeared to be firmly established. One spoke of "the OPEC order", which seemed to have taken the place of "the order of the Majors"[9]. This meant the accession of the resources-rich countries to the status of producing-countries, as well as their ambition to control the market. In fact, this situation, was to be only a transitional phase between two essentially transnational oil configurations very different from one another. After 1980, the oil sector experienced a double change which tended to make it once more an essentially transnational industry: firstly, the development of the *spot*[10] and forward markets; secondly, the return of the TNFs to the forefront of oil production, under the combined effects of a multiplication in the number of producing countries and the reopening of the upstream industries of many countries "closed" since the 1970s to the activity of the companies. It was thus a *re*-transnationalisation that was under way, but certainly not a return to an order like that of the "Seven Sisters" oligopoly. We shall see that to the transnational dimension of this new oil configuration has been added a *competitive* dimension. Fierce competition between the firms for market shares, but also between resources-rich states for access to TNFs' technology and finance, instrumental to the efficient development of their upstream, make the emerging new configuration very different from the historical concessions-based order.

3. The logic of changes in the oil economy since 1980

8. See Louis Turner, *Oil Companies in the International System* (London, Georges Allen & Unwin), 1978, pp. 200 ff.

9. The concept of oil order is developed by Bergesen, Björk and Claes, *The World Oil Market in the 1990s: is a New Order Possible?* (Polhodga, Norway, Fridtjof Nansen Institute, 1990). For a critical analysis of the concept and of its application to the period during which OPEC dominated the oil market, see P. Noël, *Logique économique et phénomènes de pouvoir dans les relations pétrolières internationales*, Grenoble (France), IEPE, 1995 (unpublished).

10 These are markets in which the transactions are immediate (and not by way of fairly long term contracts between a buyer and a seller) and are made at the price prevailing at the instant of the transaction. They involved about 4% of the volume exchanged in 1970, rose to 50% ten years later, and are now less than 25%, although *the spot price still remains the reference price for more than 90% of transactions.*

This section offers an interpretation of the changes in the oil industry since 1980, which will both explain the genesis of the current configuration and help identify the forces which will constrain and direct oil dynamics at the beginning of the new century. The current orientation of the oil scene will be analysed as the resultant of two forces: *1)* the transition *from authority to market* as the dominant mode of co-ordination and regulation — an evolution at work since the turn of the 1980s — and *2)* the *withdrawal of the state*, or more exactly the redefinition of the forms of state action within international oil relations, which reflects a change in the articulation between national sovereignty and integration into the world economy — a trend affecting both the exporting and importing countries. These dynamics push towards a new oil configuration, differing from both historical counterparts: the one which was dominated by the majors until the 1960s, as well as the order — or would-be order — of the "OPEC decade". *Diagram 1* summarises this transition to a transnational and competitive oil configuration in the 1980s and 1990s.

From authority to market

The way in which the price of crude oil is fixed was transformed radically during the 1980s, from an administered price to a market price emerging from the complex interaction between spot and futures transactions. In other words, the oil market tends to become a global oil exchange. The sequence of this change has been described many times; it makes the oil market commodity-like market.[11] What interests us here is to show its structural dimension, i.e. the way it alters the whole functioning of the industry, in turn modifying the modalities by which power is exercised in the oil game.

The influence of the new markets on the structure of the oil industry has not been studied in depth yet. Their neutrality beyond the strict determination of the short term price is often asserted; in fact, it is perhaps at the structural level that the effect of the generalisation of market mechanisms in determining the price is most pronounced. According to Yves Simon,

> The presence of public prices which are also reference prices contributes to the break-up of oligopolistic situations. The derivatives markets contribute to the creation and maintenance of instability in the organisation of the oil sector; this instability is manifested in the appearance of new non-integrated operators and in greater fragmentation of the participants. The derivatives

[11]. See for example Philip K. Verleger, 'The Evolution of Oil as a Commodity', *in* Gordon, Jacoby and Zimmerman (eds.), *Energy: Markets and Regulation*, (Cambridge, Mass., The MIT Press, 1987), pp. 161-186, or Joe Roeber, *The Evolution of Oil Markets: Trading Instruments and Their Role in Oil Price Formation* (London, The Royal Institute of International Affairs, 1993).

> markets contribute to the emergence of a more competitive and consequently more unstable situation throughout the oil sector.[12]

Moreover, the rapid development of the commodity-like markets is the source of modifications in the organisation of the oil companies: it entails the emergence of a specific trading activity, and brings about changing relationships between subsidiaries in the sense of market-based, rather than administrative, coordination.[13]

So, having materialised as instruments for risk management within a context of surplus — and therefore of downward pressure on prices — and of volatility associated with the development of the spot markets, the "new markets" — forward, futures, derivatives — have acquired *an efficacy of their own* in the transformation of the whole oil sector. As a transparent and competitive stage at the heart of the industry, they are progressively substituting to administrative/hierarchical co-ordination, both upstream and downstream. Consequently, they are diffusing the market process to the rest of the oil industry. The appearance of market mechanisms in setting prices is therefore actually leading to a very profound change: the change *from authority to market* as the dominant mode of regulation for the whole oil industry.

This distinction broadly fits what institutional economist Oliver Williamson would call a move from *hierarchy* to market. Following Susan Strange, we have to analyse its political dimensions.[14] In a configuration marked by an administrative mode of regulation ('authoritarian' in the words of Strange), the exercise of power is evident, and those exercising it easily identifiable; on the other hand, when the market is predominant, identification of power is more difficult, the sources as well as the modes of exercising being more diffused. There is a change from a power initially being exercised *relationally*, to a power being exercised mainly through the determination of the structures within which the oil game itself takes place — hence its name of *structural power*.[15]

National sovereignty and the world market: the new relationships

The second driving force of the recent and current changes in the oil industry is the modification of the relationships between national sovereignty and the global oil industry. More precisely, it lies in the changing perception by states of their national interests and

12. 'L'impact des marchés dérivés sur les prix et l'organisation structurelle du secteur pétrolier', *in* A. Labourdette (ed.), *Mélanges en l'honneur de J.-G. Merigot* (Paris, Economica, 1992), pp. 275-294 (quot. pp. 291-92).

13. Cf. Roeber, 'Oil Industry Structure and evolving markets', *The Energy Journal* (Vol. 15, Special Issue, 1994), pp. 253-276.

14. S. Strange, *States and Markets* (London, Pinter Publ., 1988), esp. 'Prologue', pp. 1-6.

15. *Ibid*., chap. 2: 'Power in the World Economy'.

of the best way of promoting them, in a context marked by strong competition between transnational firms and by the domination of a philosophy of market regulation. This change is reflected in a trend towards the withdrawal of sovereignty as the main *mediator* — or regulator — of the integration of national economies into the global oil economy. This withdrawal can be seen at two levels.

• It actualises firstly in the attitude of importing countries, which no longer see the operation of market mechanisms and the activity of the TNFs as a threat to their energy security, but on the contrary, as factors which could help to guarantee it. This is a consequence of the affirmation of the new oil configuration and in particular of a more competitive market, guaranteeing a more secure supply: 'the flexibility shown by the oil market during the 1990-91 Gulf War strengthened confidence in the ability of market mechanisms to ensure short-term adjustments and medium-term stability by preventing permanent price increases even when OPEC's production capacity was pushed to the limit'.[16]

During the course of the 1980s we observed therefore a decline in fears over energy security, resulting from the structural changes of the oil market — new market institutions, decline in the market power of OPEC, greater competition —, the real fall in the energy dependency rates of the main OECD countries compared with the 1970s, but also the progressive dissemination of a more liberal norm in the conduct of economic policies in general, and of energy policies in particular.

This movement may therefore be analysed as a consequence of the triumph of the market over the old, administered forms of sector regulation — and in particular over OPEC management — and thus of the assertion of a new oil configuration. But it is in turn proving to be instrumental in the *acceleration* of this affirmation: on one hand, governments pursue policies of deregulation of the energy industries, especially oil — liberalisation of prices, removal of controls on upstream activities, liberalisation of international trade in refined oil products …—[17], which help to establish and extend the field of market regulation in the sector; on the other, states privatise the public or mixed oil companies which means a loosening of the links between the companies and their former controlling administrations: 'The change was more rapid in the oil sector than in the electricity and gas sectors because the public companies were thrust into a competitive environment that forced the governments to grant them extensive strategic

16. D. Finon, 'From Energy Security to Environmental Protection: Understanding Swings in the Energy Policy Pendulum', *Energy Studies Review* (Vol. 6, No. 1, 1994), pp. 1-15 (quot. p. 8). See also J. Lichtblau, 'Oil Imports and National Security: Is There Still a Connection?', *The Energy Journal* (Vol 15, Special Issue, 1994), pp. 339-46.

17. Finon, *op. cit.*, in note 18, p. 9.

autonomy.'[18] This loosening of the links between states and companies helps reinforce the transnational dimension of the oil scene, i.e. the second component of the new oil configuration[19].

• The trend towards the withdrawal of sovereignty is also shown at the other extremity of the oil chain, in the propensity of the resources-rich states to reassess the link between their national sovereignty and the management or control over their oil resources. This alteration of the way states conceive of their sovereignty over natural resources and of their national interest, has very important repercussions on the fundamental elements of the oil market. In fact, although the emancipating context of the 1960s and 1970s led the producer countries to nationalise the assets of the foreign companies, the present move is towards a re-opening of these countries to the exploration and production activities of the TNFs[20]. Now, as we have already seen, this movement is an essential factor in the development of production capacities, in a context in which access to technological and financial resources is so crucial. As J.-M. Martin explains, 'The rapid removal of legal barriers to the exploration of the subsoil of our planet is a very important factor in the renewal of reserves.'[21]

This re-opening — or opening in the case of countries which were not producers before the 1980s — has initially concerned developing countries which are not members of OPEC. These include Peru, Mozambique, the Philippines, Bangladesh, Thailand, Malaysia, Colombia, Yemen, Angola, etc. One might easily imagine that OPEC has in this respect remained a kind of sanctuary; this situation will not have lasted long and Nigeria, Ecuador — which has since left the Organisation — and Algeria have modified their mining legislation to allow new partnerships with the TNFs in the upstream oil industry. The most striking example is that of Venezuela — a funding member of OPEC — which re-opened its doors at the start of the 1990s and today, among the large producers in the developing world, is the one which has pushed this policy the furthest. 'A new interpretation of the sovereignty [over resources] principle is emerging — one in which the oil industry is no longer synonymous with the state.'[22]

From the point of view of the producer countries, this change may be analysed as a *modification of the way their oil resources are integrated in the world economy*. This has been done on a *national-sovereign* way since the 1970s; it now tends to be done increasingly on a *transnational* way, the TNFs being the vehicle of this integration. In

18. *Ibid*.

19 Cf *infra*, 'The new oil configuration'.

20. Victor Rodriguez-Padilla, 'Sovereignty over petroleum resources: the end of an era?', *Energy Studies Review* (Vol. 3, No. 2, 1991), pp. 109-123. See pp. 115 ff.

21. J.-M. Martin, *Economie et politique de l'énergie* (Paris, Armand Collin, 1992), p. 188.

22. Rodriguez-Padilla, *op. cit*. in note 22, p. 122.

this context, the state is abandoning its role of direct actor in the oil game, in favour of the role of intermediary, a negotiator of the conditions of the TNFs' activity. Firm-state negotiations, so characteristic of the new globalised economy, is therefore once more becoming an essential dimension of international oil system.[23] This new role for the state, consisting of creating an environment — especially a legal one — favourable to investment, while obtaining the most advantageous conditions possible, may be seen as the role of a *competition state*.[24]

Here, we see that this second dimension of current oil dynamics — the alteration of the conception of sovereignty in the world oil game — is not dissociated from the first: it is in fact an extension of the market philosophy to the whole oil game. The resources-rich countries play TNFs against each-other for access to their reserves; at the same time as, companies consider the oil provinces all around the world as in competition with each other. The oil configuration which is emerging from these changes is, as we shall see, historically original.

The new oil configuration

The structural changes identified above suggest two fundamental criteria for the evaluation and historical comparison of global oil configurations. *Diagram 1* presents a matrix of these oil configurations, in both ideal-typical and, as far as possible, historical terms. The horizontal axis represents the dominant mode of regulation and industry co-ordination, between authority and market. The vertical axis shows the degree of transnationalisation of the oil scene, defined essentially by the mode of integration of oil resources in the world economy, dominated either by a sovereign-national principle, or by a transnational principle.

In terms of ideal-types, the oil configuration dominated by the oligopoly of the Majors was *hierarchical-transnational*, at least until the beginning of the 1960s. Hierarchical, because the regulation of the market by the firms relied on a complex and relatively formalised administrative system which allows them to restrain competitive pressure. Transnational, because the large internationalised western companies had direct access to resources, they operated under concessions giving them almost unlimited freedom to manage reserves. The integration of oil reserves into the world economy did not therefore proceed from a sovereign-state philosophy. The OPEC decade — 1971-81 — corresponds to another ideal-type, that of an *sovereign-hierarchical* order. Although

23. On 'Firm-state diplomacy' in the international political economy, see Susan Strange and John Stopford, *Rival States, Rival Firms: The Competition for World Market Shares* (Cambridge, Cambridge U.P., 1993), chap. 1.

24. The concept is borrowed from Philip Cerny, 'Globalization and the changing logic of collective action', *International Organization* (49, 4, Autumn 1995), pp. 595-625. See also Cerny,*The Changing Architecture of Politics* (London, Sage Publications, 1990), chap. 8.

the setting of the price remains essentially administrative, this period is marked by the real ‘revolution’ constituted by nationalisation on one hand, and by the progressive take-over of all the upstream operations by the national companies of the producer countries, on the other[25]. This revolution is analysed here as a radical modification of the way oil is integrated into the world economy and of managing the reserves: these now proceed from sovereign decisions.

The sovereign-hierarchical configuration is *a priori* more ‘natural’ than the cohabitation of the administrative and transnational dimensions: one can readily imagine that the market is not the dominant mode of regulating an industry in which the bulk of the supply is controlled by producer states bound to co-operate with each other in a cartel-like structure. One would have expected that these states would have had more success in their task of limiting competitive pressure than an oligopoly of firms. Historically it was nothing of the sort, the sovereignty principle proving to be a powerful barrier to the introduction of collective restraining mechanisms within the oligopoly.[26]

4. Conclusion

The two driving forces of the structural change in the oil system since the beginning of the 1980s have been detailed above: affirmation of the market over authority as a mode of coordination, and re-transnationalisation of the oil industry. Let us specify, as a conclusion, the links between these two dimensions of recent oil dynamics. We have seen that the affirmation of the market as a mode of regulation and coordination was structurally destructive of any oligopolistic and centralised management. It multiplies the number of operators at all stages of the oil chain. At the same time, once introduced into the process of price setting, market mechanisms spread inexorably into the whole sector: the expansion of market regulation is a self-enforcing mechanism. As we have seen, it affects the relations between TNFs and resources-owners states, encouraging the extension of the transnational principle at the expense of the sovereign one. In turn, in a context in which there are much more operators, the reopening of the upstream industry in the producing countries intensifies competition between transnational firms. Hence, there is a sort of bilateral causal relationship

25. A comprehensive overview of the structural changes of the 1970s can be found in Mary Ann Tetreault, *Revolution in the World Oil Market*, (Wesport, Conn. and London: Quorum Books, 1985).

26. On these ‘supra-sovereign’ mechanisms, their decisive role in the success of the oligopoly of the Majors and the inability of OPEC to set one up, see the article by Theodore 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’, *International Organization* (41, 4, Autumn 1987), pp. 576-607.

between the expansion of market process and transnationalisation. Its logical outcome should be the establishment, as the new century begins, of an oil configuration, *transnational and competitive* in nature.