

The Future World Oil Market: State of Nature or Social Contract? Comments on M.A. Tétreault's article

By Pierre Noël

Institute for Energy Economics and Policy
University of Grenoble (France)

noel@iepe.upmf-grenoble.fr

Mary Ann Tétreault's article on "the philosophy of upstream reorganisation" (*Oxford Energy Forum* No. 38) is thought-provocative. It is full of very accurate views on the emergence of a new relationship between international oil companies and resources-rich countries of the Middle East.

The original intellectual tools she handles—concepts skilfully drawn from the European political philosophy tradition—lead her to sketch the following three-steps picture: (1) the oil market left to himself—whether participants are states or firms—behaves like a Hobbesian "state of nature" often resulting in a situation damaging to each participant; (2) to get out of it, the international oil community, as we shall see it, has historically tried several organising schemes, but these *social contracts* or "republics" were inherently unstable since they rested on too narrowly defined interests; (3) the rationale behind the fledgling coming back of oil companies in their former Middle East concessions providers is the search for new "international oil republics" able to "offer greater security and higher profits for all the good republicans among them".

The market as a state of nature, revisited

Let us start these comments with a discussion of the concepts themselves. In what sense are we to understand the idea that the market is a *state of nature*? It is contestable that the way classical philosophers imagine the cohabitation between individuals in the state of nature fits that of agents engaged in an economic activity. For the very core of the social contract political theory—whether in the liberal Lockean tradition, the absolutist Hobbesian one, or the Rousseauiste critique of the latter—is the idea that a sovereign power is required as a requisite to any lasting collective order. What about the market? The order emerging out of the market process *does* require such an authority, able to enforce contracts and to "sanctify" property rights: it is abundantly clear from Adam Smith's *Wealth of Nations*, as it is from contemporary neoliberals such as Friedrich Hayek, Ludwig von Mises, even libertarian American political philosopher Robert Nozick. The market process, even for the arch-free-marketers, *cannot* take place in a state of nature.

But Tétreault still has a point: we can infer, e.g. from the two savages' hunting party in Rousseau's *On the Origin Of Inequality*, a more benign version of the state of nature. The problem associated with the lack of sovereign authority is no more one of civil war and peace, but one of coordination between individuals engaged in a collective action. Would Rousseau's hunters have been bound by a "social contract", they could have directed their individual efforts to a more rewarding collective result; the defective coordination arises from unlimited freedom of action. Arguably, a market may here be seen as a state of nature, as opposed to an organisation where individuals are *under contract*—i.e. bound by a set of rules designed by reference to a collective goal. (French sociologist Raymond Boudon had suggested such a qualification of the market as a state of nature in a 1984 book entitled *Effets pervers et ordre social*.) But if we accept such a qualification, two points should immediately be made:

- Many such "states of nature" persist once the political community has empowered a sovereign authority—when a social contract has taken the collective life *out* of the (Hobbesian) state of nature. In fact they are everywhere in the social life of modern states. The innumerable producers competing on, say, the market for *baguettes* in Paris, interact with each other in what Tétreault and Boudon would call a "state of nature": no authority ensures that the behaviour of each one of them remains compatible with the interests of whoever among them, let alone with a possible common interest of all the bakers.
- Those "states of nature" are widely seen as beneficial to the society and the economy. The only job of an antitrust authority is to make sure "states of nature" prevail and are not discreetly replaced by "social contracts". For the other name of Tétreault's "state of nature" is the *competitive process*. Of course, economic agents often (always?) find it hard to live in a state of nature; unfortunately that is precisely the reason why society wants them all to remain in such a state. Adam Smith's *invisible hand*, far from neglecting that the market is a state of nature—as M.A. Tétreault implies—is based on it.

The idea that the market behaves like a state of nature can only be understood with reference to the second acceptation—the sociological one, so to speak. But contending such a state of nature is damaging and should be replaced by something else is not correct, as it borrows the pejorative aspect of the political state of nature, which refers to something very different—the war of everyone against everybody, in Hobbes' words. Behind these unusual words is a very usual debate about competition in the oil market.

The competitive process: between constraint and emancipation

The history of the oil market—even before it became international—can be viewed as a never-ending contest between the efforts of participants to enter into some form of social contract, and the natural drive towards a state of nature. The former has historically prevailed, to such a point that many have argued that competition is not sustainable in the oil industry—mainly because of costs structure—and that producers entering into joint industry planning perform a task of general interest. Among them is Paul Frankel and other economists from the business, as well as many governmental and pro-OPEC analysts from 1970 onwards. M.A. Adelman—with a few others—has spent a prolific academic life to demonstrate that competition is not only possible but highly desirable—at least to final consumers—, even if the competitive process has indeed often been constrained.

Since the end of the 1970s, this story actualised as the progressive generalisation of the market process as the governing force and the prime mover of the industry dynamics. Yet fifteen years of market process dominance have left us with a far from competitive world oil market. The reason is that a handful of producers are still loosely bound by a “social contract” dedicated to market control. The quota system is dead, along with the formal cartel; but the prize is high enough to make unilateral restriction rewarding, and to allow punctual collective action as the one we are currently experiencing. The result is a market more erratic than ever, where periods of rapid drive of prices toward costs alternate with sharp but short-lived upward swings.

In the late 1980s and early 1990s, the mood was to claim for a new age in international oil relations, one of far-reaching cooperation rather than confrontation, of “constructive” dialogue rather than “destructive” pursuit of self-interest. Many saw the downstream investments of national oil companies from OPEC countries as a first step toward this new oil order—indeed, vertical re-integration was perceived as a requisite to the coming of an *âge d’or* of soft-planning, bringing comfort and stability to everyone involved.

Nothing like that really emerged and world oil is now severed in a two-logic game. On one side is a highly competitive market where international oil companies and landowners—mostly sovereign states—compete for market shares, rents, reserve growth and replacement. On the other side are a few producing states acting as *both* landlords and entrepreneurs, with large and low-cost reserves and a strong short-term interest in preventing price to drive toward costs. The larger the first side expands, the harder the life for the second group. The larger the “state of nature” side, the harder it is for would-be “social contractors”.

This is the context where the companies could be invited back to do business in the large-reserves low-costs countries of the Middle-East. There is, as I understand it, only one alternative deserving attention: Will those states tend to become mere landowners entering the competitive game, privatising their NOCs and offering acreage to international competitors? Or will the door be open very partially, with companies entering into deals that allow hosts countries to perform their hard job of monitoring the market? The first side of the alternative would imply the progressive move toward a competitive world oil market, with diminishing rents as price is brought down on costs. The second one would mean a strained status quo. Of course, there are many possibilities between these two, but the underlying logic is left unchanged anyway. The key question is that of the constraining or the emancipation of the competitive process in the world oil market.

The myth of soft-planning

Hence I find it hard to understand Tétreault's idea that the arrangements between oil companies and Middle East countries, provided they are properly designed, would offer "more representative republics" than historical counterparts, allowing "the survival of competition as a spur to efficiency", while offering "an as-yet-untried avenue toward industry stabilisation in a period of market turmoil." Her concept of "republic of hydrocarbon" as opposed to the "Hobbesian state of nature" the market is supposed to be, sounds like a renewal of the soft-planning idea—in short: competition is so hard a state to live with that there must exist a benign way of rationalising the market, with common interests prevailing over the pursuit of self-interest.

But this is an oil myth we should get rid of. The world has changed once and for all. The American monitoring of the interwar period took place under the auspices of authorities with police power and a sovereign federal authority performing a coordination task—note that the politics of the *proration* was so suffused with vested interests lobbying and corruption that it had little in common with Tétreault's "Kantian republic", even if it has certainly been welcome by most producers. The system of the *majors*—the other reference of the rationalisation myth—rested on a few conditions that will never be found again: country-wide concessions in the most favourable areas; joint ownership of major production affiliates; vertical and horizontal integration, both financial and operational; partial exemption from antitrust laws in downstream activities, etc—a perfect "social contract" not even sufficient to prevent competition from eventually emerging.

The market as we now live in has so many participants, is so profoundly de-integrated, so marked by the globalisation trend, so influenced by the liberalisation of oil regimes everywhere in the world, that it is impossible to imagine an alternative to competition as the prime mover of world oil in the decades to come. And in oil like anywhere else, competition is a process by which the economic floor to price is discovered. The question is whether some OPEC governments—probably helped by non-OPEC ones, and perhaps supported by the U.S.—will be able to constrain the development of the competitive process, and to what extent. One can bet they will. Big oil companies anticipate they won't and merge to survive and make profits in the new environment—would current industry consolidation have occurred if top managers had believed 20 dollars was the rule and 10 dollars an accident?

The reopening of the Middle East subsoil to private investment, depending on the modalities, may make slight difference with the current situation of the world oil market. But it is difficult to see how it could re-empower OPEC to effectively control the market—as N. Aït-Laoussine optimistically suggests in his contribution to the *Forum* symposium. As it is hard to imagine how it could serve as the basis for an alternative to the continuing expansion of the competitive process: the “as-yet-untried avenue toward stabilisation” may be a cul-de-sac, of which the most probable issue is more competition, hence lower price.