# **ENERGY** AS AN INSTRUMENT OF FOREIGN POLICY



## INTRODUCTION

Developing policy to regulate foreign relations and trade is a culmination of factors which states rely on to create and maintain guidelines to approach foreign nations. These set of standards consist of strategies aimed at maintaining the self-interest of the state to secure its national interests and to carryout state goals within the realm of separate foreign agencies and the overall international domain.

While a state's foreign policy is mainly driven by it's domestic policy, there are several factors within a country, which dictate the development of these standards and policies. The following list is a brief introduction to foreign policy to provide perspective while examining the overall scope of utilizing energy as a tool of foreign policy. Several major factors that go into foreign policy decisions include: political ideology and leadership, geography, historical precedents, and a country's economic standing.

The leadership and political structure of a nation leads policy decisions both domestically and internationally through the decision-making process as well as the political sentiments of both the leading party and country leader. This direct influence is noted mostly within attitudes related to armed conflict as an extension of national policy and the extent to which lawmakers see policy formation as collaborative (Marlatt). The political structure of the government, whether a democracy, oligarchy, or other form, dictates how nations specifically create and administer foreign policy and is relative to how the nation creates it's own domestic policy.

The geographical location of a state also plays a pivotal role in the development of its foreign policy. This determinant involves not only the influence of regional political actors, but also the size, climate, and resources within the country. States lacking substantial natural resources often place a different set of priorities on is exports versus imports when determining its policies related to foreign trade. In the same way, nation states that are resource-rich, and as it relates to this paper, oil-rich, determine a large amount of their foreign policy upon this commodity.

Historical precedents can be one of the more complicated influencers of foreign policy. As each nation has formed, they have done so with ties from historical events and political decisions, creating precedents, which dictates current and future policy. Countries will often hold onto past relationships and policy decisions to continue to help guide their foreign policy arrangements. Generally, the best predictor of what a nation will do in the future is what they have done in the past.

A final determining factor of a country's international policy includes its economic standing. This relates to several things, including the stage of a country's industrialization, and what type of economy the country maintains. The ability for a country to keep up with the world in producing goods and services directly relates to its stage of industrialization, which in turn determines the country's ability to enact strong foreign policy. The type of economy that a country employs dictates decisions, which are intended to further the self-interest of the country and differ between forms of national economy from a free-market economy to a more social-centric economy.

In summary, a state's foreign policy is composed of numerous diverse factors, which affect policy, however, a theme remains throughout these examples and the following paper. All actions taken to either enhance or restrict a state's international influence are motivated by the nation upholding its self-interest through the different policies it maintains.



## CONTEXT

In most industrialized states, energy is incorporated into foreign policy in some form. With the importance of international trade to economic health, a country's comprehensive foreign policy must account for trade. Global commerce was the impetus for early exploration and has shaped borders and cultures throughout history. Trade links nations to one another, establishing relationships that can benefit or punish trade partners. As an element of trade, natural resources and energy are becoming increasingly valuable. They create the potential for a country to become a major power in the world and to expand its influence across the world. Many resource-rich countries find the power to manipulate bordering countries and alter the decisions of foreign governments. The use of energy as a tool for policy both in terms of encouraging and discouraging behavior is examined below. This paper looks at several examples of well-established and emerging energy policies and analyzes trends and potential for the role of energy within the context of foreign policy.

#### **GLOBAL CONTEXT**

Geography is the most important factor in energy diplomacy. Possession of resources is critical, however, the ability to trade them is just as critical. The United States, which borders only two countries and two oceans, is not ideally placed for trade, like Russia for instance. Geopolitical power comes not only from having abundant sources of natural resources but also the political will necessary for energy production; to actively pursue energy policies while complimenting economic and military power. Just as Saudi Arabia and more generally the Middle East is recognized as oil powers, Russia has been traditionally viewed as the gas giant, keeping in mind Russia's tremendous oil production and resources as well. Its energy empire expands deep into Europe and Asia, affecting dozens of economies and impacting government decisions. Countries in South America, Europe, and Asia all use energy as

a device for power, control, and influence throughout the region and the world. In some cases energy is clearly linked to foreign policy goals and pressure is applied to trade partners. Some countries use energy as economic policy, increasing their wealth and power and indirectly affecting foreign policy. With 87% of the world's energy supply originating from fossil fuels, the world's largest economies focus on oil, natural gas, and coal for supplying energy (Dryer and Stang, 2014). While oil has been the major fuel of the last century, the importance of natural gas has expanded in recent decades due to innovative extraction techniques and lower environmental impact.

#### **EUROPEAN CONTEXT**

Two thirds of the world's natural gas pipelines run across Europe (Shaffer, 2012). Led by Russia, European energy policy is a prime example of how foreign policy goals can be achieved through non-traditional mechanisms. Some European countries rely entirely on gas from Russia, and much of the continent remains somewhat dependent. Gas must travel through pipelines, which requires crossing several borders to get from Russia to the consuming countries. The former Soviet countries, which border Russia, constitute the transit states. Many issues persist between Russia and its bordering states, causing supply disruptions that can affect the transit state and every country downstream. Moderate military aggression between these states and Russia has been common in past decades. With a majority of natural gas to Europe coming from Gazprom, the Russian state-owned energy company, price increases often accompany supply disruptions.

#### AMERICAN CONTEXT

Leading the world in production of natural gas and petroleum products, the United States economy is thriving as a result of its energy sector. With innovative extraction methods, such as hydraulic fracturing and directional drilling, U.S. energy companies have taken the lead, with the government focusing more on domestic energy production than foreign policy. As a nation historically and culturally bound to the ideals of individualism and entrepreneurship, U.S. attention is focused on energy independence and economic



improvement. The market approach to energy allows companies to advance U.S. interests and stimulate the economy while using domestic sturdiness to promote stronger foreign policy.

## EVOLUTION OF ENERGY POLICY

#### CARTELS

As a mechanism for controlling markets and manipulating policy, cartels formed in the energy sector in the 20th century. Colluding with other producers, energy suppliers were able to artificially reduce supply and increase prices for personal gain. The profit incentive originally brought cartels into existence, but policy implications became evident when resource-rich countries began allying with each other.

#### OPEC

In 1960, the Organization of the Petroleum Exporting Countries (OPEC) was created, altering the global oil market and establishing a new era in energy policy. Introducing the element of government control over energy, OPEC overpowered the private corporations, which made up the majority of the energy market. Throughout the middle of the 20th century, several oil companies known as the Seven Sisters controlled up to 85 percent of global reserves of petroleum. The companies lowering oil prices led Venezuela and Saudi Arabia, along with several other Middle Eastern states to form OPEC in an effort to synchronize energy policies and increase the price of oil.

#### **STATE CONTROL**

State ownership of energy companies was a necessary follow-up to cartel-led markets. In order for countries to join OPEC, they had to be in control of the oil within their nation. Many states bought controlling shares of oil and natural gas companies so the governments could make decisions about where, when, and how much to produce. Foreign policy was strengthened in states with nationalized energy companies because the governments had new sources of revenue and greater power to alter energy policies. As a prevalent tool for foreign policy, state control began in the early 1900s and continues today.

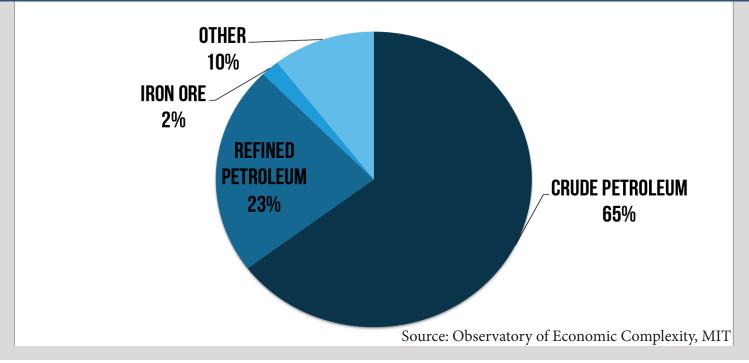
#### VENEZUELA

Oil is the lifeblood of the Venezuelan economy. Petroleum products make up the majority of its gross domestic product and over 95 percent of its exports (CIA, 2015). Given the dependency of the Venezuelan economy on petroleum exports, it is a prime example of state-run energy and foreign policy.

In 1943, Venezuela took steps to nationalize its oil industry with the Hydrocarbons Law, which gave the government 50 percent of oil profits. By the 1970s, the government acquired control of the oil industry and created Petroleos de Venezuela S.A. (PDVSA), the state-run energy company. To effectively manipulate policy, law required PDVSA to hold majority ownership in all petroleum projects across the country. With the controlling stake in the energy sector, Venezuelan foreign policy became centered on oil.

Through a program called Petrocaribe, Venezuela wields influence over 17 Central American and Caribbean states, exporting oil to these nations at below-market prices. The relationship establishes Venezuela as power of the region and ensures that the other countries toe the line with whatever decisions Venezuela makes. Examples of this conformity are as recent as 2014. When a Venezuelan anti-government activist sought the attention of South American and Caribbean countries at a forum in Washington, D.C., members of the Organization of American States (OAS) voted almost unanimously to keep the speech off the record (Lopez, 2014). As Petrocaribe members, the states knew that they could not allow speech against Venezuela or they could lose their low oil prices. By creating dependency on its supply, Venezuela is able to advance foreign policy influence merely through the perceived threat of disrupting supply. This powerful instrument of foreign policy works by itself, inducing and deterring state behaviors without Venezuela having to display force.

## **TOP EXPORTS IN VENEZUELA**



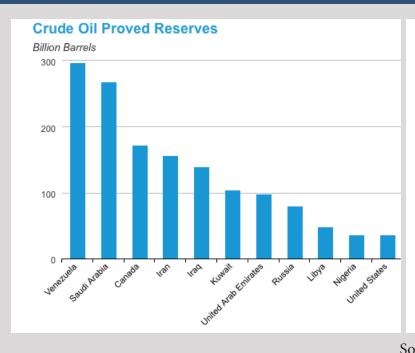
At the same time, the economy of Venezuela depends on trade within these nations. The interdependency leaves little room for either side to upset the balance. Venezuela could stop supply to a country, but would lose vital revenue, leaving a delicate situation requiring relatively stable supply and distribution, unlike Russia, which can stand to create supply disruptions for political ends. This situation brings out an important condition for effective energy foreign policy- diversification. The Venezuelan economy is insufficiently diversified, leaving it susceptible to economic disaster if the oil industry is threatened. With a more diversified economy and energy policy, Venezuela could use energy more effectively by shifting the dependency more onto importers of oil. The greater the inequality of dependency between trade partners, the greater manipulation can be made by the less dependent country (Shaffer, 2012).

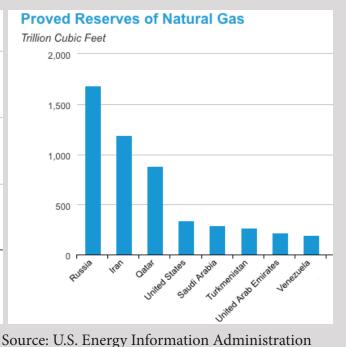
Diversification in the energy sector can also help fend off the problem of overusing energy. A country that overplays the energy card could weaken its position and give trade partners insight on the strength of the country's foreign policy. Venezuela is an example of a country which has foreign policy focused around energy. Removing or weakening the oil industry could eliminate much of the influence Venezuela has in the region. With a large portion of exported petroleum coming into the U.S., Venezuela would be particularly vulnerable if the U.S. decreased imports as a foreign policy measure. Russia demonstrated overuse of energy policy in the 2006 and 2009 Ukraine disputes, which shocked the entire EU and awakened European countries to their dependency. As a result, many countries, and the EU as a whole, began developing strategies to wean off of Russian gas dependency.

#### RUSSIA

The most prominent and controversial modern example of energy-related foreign policy comes from Russia. The wealth of natural resources and political climate of the country make it the premiere energy policy state of the world. Using energy as a lever of foreign policy, Russia achieves political and economic goals and

#### **PROVED RESERVES - 2014**





spreads its influence through its energy trade. A major and policies of shift toward using energy as a foreign policy tool began Russian infrastrin the early 2000s when the Kremlin began purchasing exports.

in the early 2000s when the Kremlin began purchasing ownership and acquiring control of the energy sector (Milov, 2006). Government-owned energy companies provided the opportunity for energy policy to fit in sync with foreign policy.

Context is everything when viewing Russia. In most cases, Russia is the exception and not the rule as its energy trade and relationships are atypical for resource economics. This is partly due to the high-level and active participation of government officials, and their persistence using energy as a tool for foreign policy. Russia dominates with both supply and infrastructure. During the USSR years, pipeline infrastructure was laid across Eastern Europe and Central Asia. The importance of the pipeline is that it was built as domestic infrastructure and became internationally significant with the breakup of the USSR. Russia maintained ownership of this infrastructure, a large portion of which runs through former Soviet countries. Because of this, Russia is able to manipulate the energy exports and policies of other countries by forcing them to use Russian infrastructure while also thriving with its own exports.

Frequent disruptions in supply to small former Soviet countries has made Russia appear unreliable as a supplier, however, these disruptions are highly calculated moves by Moscow which account for the varying level of dependency on trade and the policy goals which can be achieved through the disruptions (Shaffer 2012, Lough 2011). In some cases, Russia has shut off pipelines through transit countries and built new pipelines bypassing those countries entirely as punishment. In fact, most international cases of supply disruption involving natural gas and political motive are associated with Russia (Shaffer, 2012).

Price controlling and manipulating is another game of Russian aggression (Kaplan & Chav). Oil is traded on the global market, and prices are dependent on market supply and demand. Natural gas, on the other hand, is traded differently, mainly through pipelines directly between two countries. Natural gas, therefore, is traded



### CASE STUDY

Relative dependency is a key element of Russian energy tactic. Russia trades natural gas with countries of varying levels of dependency. The countries that are more dependent on gas experience greater disruptions in supply and price fluctuation as Russia manipulates them for policy goals. In Georgia, for instance, Russia has disrupted supply to pressure the Georgian government to change its security policy, which leaned toward the U.S. and NATO. It is also suggested that the energy disruptions were used to create instability and pressure pro-west Georgian president Mikhail Saakashvili. In early January 2006, Saakashvili wrote an Op-Ed in the Washington Post promoting western energy security and reduced reliance on Russia. Days later, and during a particularly cold winter, when energy demands in Georgia were high, explosions near the Georgian border severed supply of natural gas into the country.

Russia had been pressuring Georgia to sell ownership of a pipeline system, and according to Georgian President Saakashvili, Russia had sent veiled threats in the weeks leading up to the supply disruption. The blasts were viewed skeptically in Georgia because they coincided with the coldest winter in decades when Georgia was most vulnerable. Two separate blasts occurred, and investigations found that they were intentional. Later the same day, a power cable bringing electricity into Georgia was also severed following two more explosions. All four explosions took place in Russia, but had no impact on domestic energy supply. Russia denied involvement and opened a criminal investigation, ultimately concluding terrorists were probably responsible, though no group ever claimed credit.

According to the deputy energy minister in Georgia, the country had lost 100 percent of natural gas supply and a fourth of its electricity that day. The shortage left Georgia only able to supply 40 percent of the electricity demanded by its population, forcing rationed supply to schools, hospitals, and homes (Walsh, 2006). With millions out of power, hundreds of Georgians waited in lines in the snow outside the capital for kerosene, firewood, and propane (AP, 2006). Politics took center stage during the crisis, even with no proof of Russian involvement. Georgia cut off gas supply to the Russian embassy in Tbilisi and in turn, Russia cut gas supplies to the Georgian embassy in Moscow (Whelan, 2006). In the same month, Gazprom nearly doubled the price of natural gas for Georgia, raising the cost from \$63 per 1,000 cubic meters to \$110. In November of 2006, Russia threatened to cut supply if Georgia and Belarus did not agree to pay \$230 per 1,000 cubic meters, nearly a quadruple increase in price since the start of the year. These price increases come even as Gazprom production increased in each of the five years before (OAO Gazprom Annual Report, 2007).

Russia does not rely on Georgian demand, lending credence to the belief that price increases and disruptions are political in nature. By contrast, Germany depends on Russian gas, while Russia depends on Germany's money. This interdependence means very few supply disruptions occur. Russia has incentive to get product to Germany and maintain a stable supply and price, but can afford to take riskier and more aggressive actions with countries Russia does not depend on. through long-term contracts and permanent infrastructure linking the two countries. A few tactics used by the Russians include proliferation of misinformation, military aggression, and supply disruption.

By promulgating rumors of a shortage, Russia has scared many European countries to renew long-term contracts and strengthened their dependency on Russian natural gas (Lough, 2011). This propaganda-fueled policy benefits Russia economically and gives the nation more power over its neighbors and trade partners. Invasions of Georgia and Ukraine are highly correlated with price increase across Central Europe. These intentional and self-inflicted supply disruptions allow Russia to blame conflict for the supply inconsistency while simultaneously displaying both military and energy force. By wielding the power to affect prices and in some cases threaten the energy grid for entire countries, Russia uses energy as a weapon. Cutting supply in the winter could kill thousands just like warfare (McElroy, 2014). Just as minor military conflicts can apply pressure, alter governmental leadership, and kill; energy policy has this power while going almost undetected as a form of overt aggression.

Russia has benefited from its energy policy beyond establishing itself as an energy superpower. Strategically gaining entry to foreign markets and creating interest in its resources allows Russia to expand its influence. Entering the Asian market has given Russia a new source of demand for its product and allows for political influence across the Asian continent. Investments in Cuba allow Russia to manipulate the Cuban government and maintain close proximity to the U.S. coast. Establishing itself in foreign markets increases the presence of Russian ideology and benefits nationalism by expanding influence and control into foreign parts of the world. Advertising its resources and building interest in its energy sector, Russia has attracted international business to invest in its energy resources, reaping the benefit of American innovation and technology (Lough, 2011).

### EMERGING POLICY UNITED STATES

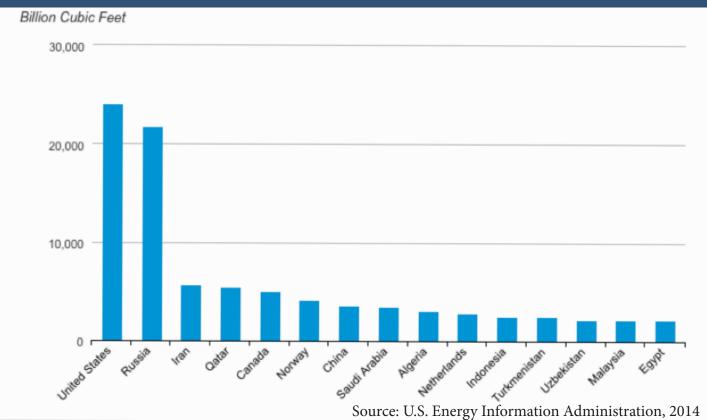
Many would suspect the United States has no discernible energy policy within its comprehensive foreign policy strategy. While geography likely has much to do with this, political motivations contribute as well. Much of what pushes the energy policy of the U.S. is private industry. Throughout its history, U.S. private enterprises have driven expansion, innovation, and ultimately policy. Frequently, the actions of private companies find their way into foreign policy. In this way, energy companies from the U.S. expand across the globe, inadvertently spreading U.S. interests and becoming loosely incorporated into foreign policy. The federal government might not take an active role, such as with Russia's Gazprom, but the U.S. government accounts for independent business decisions through the advancement of U.S. political sentiment and growth of the economy resulting from the energy trade in a sort of reverse foreign policy making.

The major extent to which the U.S. involves itself in energy policy is through its support for allies. Releasing statements to affirming claims that allied countries have to energy exporting while opposing pipeline aggression make up much of the formal involvement. Economic sanctions are used in conjunction with these stances, but for the most part, the U.S. does not take a proactive role in shaping policy outwardly. Much of the U.S. reach into energy markets and global resources is from American corporations and not government action. As a world leader in production, the U.S. has the potential to export oil and natural gas and strategically develop foreign policy. Unlike every other continent, North American countries are relatively isolated from other countries. Unless transported through pipelines, natural gas must be liquefied for transportation, limiting the export potential for the U.S.

In 2011, the Bureau of Energy Resources was created within the U.S. State Department to begin to incorporate energy into foreign policy. As resources are



### **U.S. DRY NATURAL GAS PRODUCTION**



extracted from the U.S. in the coming decades, a shift from importing to exporting could occur, leading the new bureau to an important role in energy diplomacy. While leading as a producer, the U.S. also leads the world in consumption of energy resources (Energy Information Administration, 2014). For this reason, production must exceed consumption before a substantive policy can take form.

Establishing energy independence could be a vital step for the U.S. as it pertains to security and foreign policy. Many countries throughout South America and Eastern Europe are dependent on energy or resources from another country and can therefore be manipulated. Removing the potential for intimidation or pressures from energy suppliers could strengthen the force of foreign policy for the U.S. Since 2008, U.S. imports from OPEC have fallen by 60 percent (Bastasch, 2015). This has boosted the economy and reduced reliance on foreign nations. With independently supplied energy, U.S. policy could be entirely offensive, similar to Russia, which does not have to defend itself from trade partners due to its dominance. Russia, however took this a step further by buying a controlling stake in large energy companies and forbidding 50 percent foreign ownership of Russian companies (Milov, 2006). Eliminating competition and maintaining complete control allows Russia to have flawless crossover between energy and foreign policy whereas the U.S. focuses on allowing private companies to take the lead.

#### **TURKMENISTAN**

Possessing the world's fifth largest reserve of natural gas, Turkmenistan is preparing to integrate energy into its foreign policy. Under pressure from Russia to use its pipelines, Turkmenistan is building its own pipeline network to thwart Russian influence. In response, Rus-

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sia has attempted to sow doubt with potential customers of Turkmenistan that they cannot maintain stable supply and lack adequate technology (Rinna. 2013). The Russian propaganda, however, is less effective when used against a resource-rich country that has no dependency on Russia. Turkmenistan has remained relatively neutral in regional politics with its energy resources, but it is expected that their foreign policy will take the shape of drawing closer to either Russian or Western influence. Potentially the establishment longterm contracts and supply routes into Europe could strengthen relationships with NATO, the EU, and even the U.S.

Thus far, energy has not been markedly incorporated into foreign policy, though pipelines into Iran and China are flowing. The government and economy of Turkmenistan are not stable enough for foreign policy goals to be achieved through energy trade, and the foreign policy goals it wants to achieve are unclear.

# FUTURE

Many signals indicate that Russia will lose its foothold as the dominant energy superpower in the coming decades. While much of Central and Eastern Europe is dependent on Russia to some extent for energy, emerging markets and innovation will likely open the door to competition. Innovations in technology followed by increases in supply around the world will reduce the power of Russia's supply and price control. Turkmenistan has construction plans for pipelines into Europe to offset Russia's monopoly. The EU and its individual member states are aware of the Russian dependency problem and have begun taking steps to address it including investing in renewable energy, conserving energy, and seeking other sources of energy (Lough, 2011). Additional tactics by the EU to develop better energy policies include cooperation with the U.S., Japan, and China, sitting down with Russia for meaningful, rules-based trade, and incorporating energy into its own foreign policy instead of being a part of someone else's foreign policy (Dryer and Stang, 2014). Finally, the EU implemented legal means to

protect itself through the Third Energy Liberalization Reform Package, which prohibits one company from controlling production, distribution, and sale (Kaplan and Chausovsky, 2013). This would directly affect Gazprom, which is vertically integrated and controls all these stages. Despite Russia's vast proven reserves of natural gas, the U.S. recently surpassed the Russia and Saudi Arabia as the largest producer of natural gas and petroleum, respectively. As the U.S. and North America move towards energy independence, exports and foreign policy will likely focus on Europe, which has already hosted American energy companies.

Attention also must be paid to environmental impact and carbon footprint. As climate change take a more prominent role in international dialogue, energy production and foreign policy could be affected. This could lead to an increased focus on natural gas, as one of the least impactful fossil fuels. Several European states have already banned hydraulic fracturing in favor of more environmentally friendly methods of energy collection, such as renewable energy. As more studies are completed, fracking will either become more prevalent or more restricted. Perhaps the EU will move in favor of fracking as a means to further divide from its Russian gas dependency.

#### COUNTEREXAMPLES AND ECONOMICS

Not all energy policy is foreign policy, and to that end, not all disruptions are political. While energy policy is a category of economic policy, changes in trade relationships don't necessarily fit into foreign policy framework. The case of Egypt, Israel, and Jordan is a complete example of an almost purely economic trade separation.

Between 2008 and 2011, Egypt agreed to supply Israel with natural gas. Despite contractual obligations to send natural gas into Israel and Jordan, Egypt experienced domestic regime instability and increased energy demands. Israel became moderately dependent on Egypt during the trade and to cater to domestic demand, Egypt slowly reduced supply to Israel. Some erroneously attributed decreased supply and pipeline

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disruption as foreign policy moves- Egyptian attempts to punish or manipulate behavior- but the situation was mainly economical. Egypt couldn't continue to export while its domestic demand increased and tumult in the region made it more difficult and expensive so their contract was broken.

While the countries shared political alliances, the decision to disband trade could have resulted in foreign policy tension. Alternatively, some believe, as Israel did, that natural gas contracts and trade agreements could build or strengthen peaceful alliances with new trade partners (Shaffer, 2012). As an instrument of foreign policy, a steady energy trade with a country could benefit both countries economically and politically, and provide a reason for communication between governments. This assumption is frequently incorrect and if supply instability occurs can have damaging opposite affects (Shaffer, 2012). Energy relations do tend to exist between states with a high level of interaction and political cooperation, but do not tend to create cooperation, and these already cooperative relationships are not without supply disruption (Shaffer, 2012).

# CONCLUSION

Natural resources have always been a source of power throughout history. Possessing raw materials leads to industrial and political growth, and along with exploration and trade has interconnected the world. Since the 20th century, the coveted resources have overwhelmingly been related to energy and as the importance grows, so do the applications for such resources. Together with international trade, energy has become a powerful tool to achieve and manipulate foreign policy goals around the world. Oil was the main tool in the energy policy repertoire for a long time as many cartels used it to manipulate global supply and prices. Recent history has seen a rise in natural gas as an important tool and even weapon for policy goals. Those who control resources have the ability to control political and economic outcomes for themselves and others.

Many countries choose to advance foreign policy in different ways, but most incorporate energy as a strategy to induce or deter behaviors. While some countries rely on state-run energy companies to advance foreign policy, others like the U.S. allow private enterprises to take the lead. Foreign policy is not complete without energy, as it plays into several of the policy considerations. As the global economy evolves and the demand for natural resources increases, the role of energy in foreign policy making will become essential.



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