



NEW DIMENSIONS, NEW CHALLENGES

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As ministers, heads of international organisations and CEOs gather in Kuwait for the International Energy Forum and the parallel International Energy Business Forum, it is clear that the producer-consumer dialogue, now in its third decade, has acquired new dimensions and is facing new challenges. New dimensions, because membership of the IEF has widened far beyond those of its founding pillars of OPEC and the IEA. At present, the IEF member countries account for more than 90 per cent of global oil and gas consumption and production. New challenges, because expansion of membership increases diversity of interests and makes it no easier to bring a concerted approach to coping with demand strains from fast-growing emerging economies and supply shocks in producing countries, most recently in Libya.

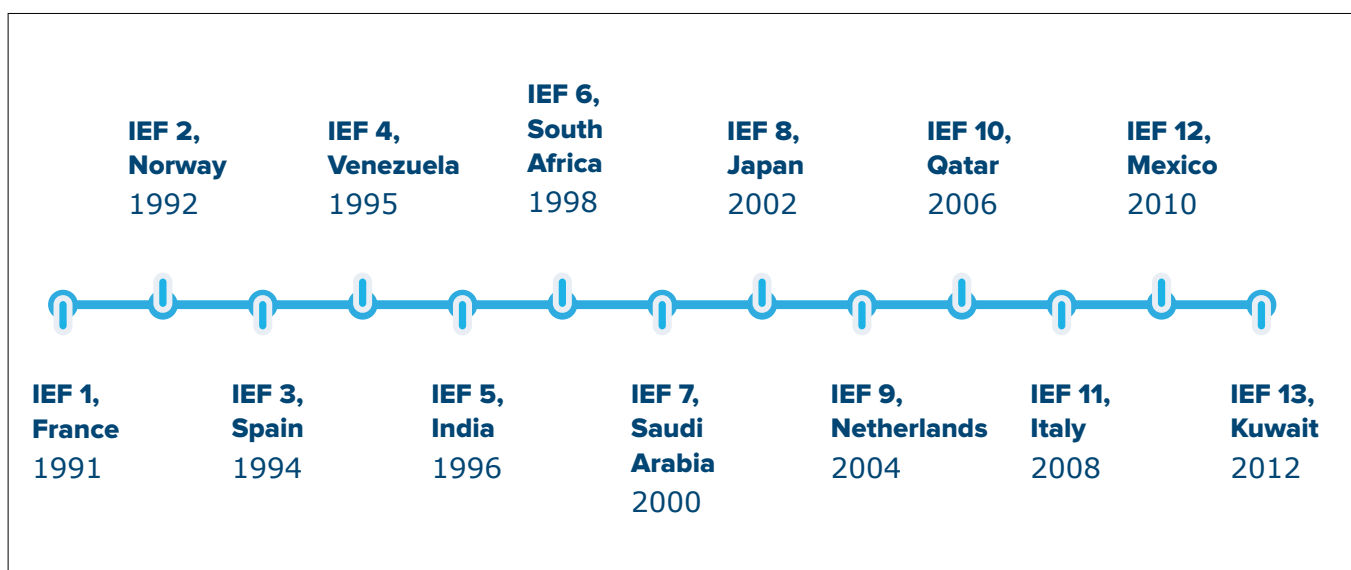
The main achievement of the IEF, since it first met in Paris in July 1991, is its success in overcoming the tension that marked producer-consumer relations in the 1970s and 1980s and in increasing the awareness of energy interdependence. The dialogue has also succeeded in bringing closer the two main consumer and producer organisations: OPEC and the IEA. Moreover, the IEF's new Charter, adopted in Riyadh in February 2011, calls for further cooperation.

A visible and concrete example of success in the producer-consumer dialogue is the establishment of the Joint

Organisations Data Initiative (JODI). The IEF Secretariat has consistently promoted JODI as representing “the single most important collaborative effort to address the issue of market data transparency.” The promotion of greater transparency in energy markets has been a recurring key message in most international gatherings and is considered crucial to achieving more predictability in both supply and demand. There are still critical problems in providing timely and reliable data on all IEF member states. Yet JODI remains the most comprehensive attempt to collect such data. JODI has also raised awareness of the technical difficulties in improving the reliability and timeliness of energy data. This has led the Secretariat and its partners to play a more active role in improving data collection methods in different countries through providing advice, organising workshops and conducting training sessions.

The IEF has also achieved a certain degree of institutionalisation, which has helped to give the dialogue more structure. This, however, has not induced any shift towards creating a global energy organisation with binding global energy governance, nor has it affected the informality of the dialogue, to which all parties remain strongly attached.

The intensity of the dialogue has been driven largely by key market events. Of these events, oil price instability has been the most important. It is interesting to note, though, that while the parties' main concerns are about



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the level and volatility of the oil price, neither consumers nor producers have an interest in managing the price level. There is an implicit agreement that the determination of the oil price should be left to market forces.

Historically, producers and consumers have had very divergent interests: producers tend to favour higher prices while consumers favour lower prices. In a rising market, producers lose interest in policing the upper boundary and, when prices fall, consumers lose interest in policing the lower boundary. There is also a clear power asymmetry in the short term. While producers have options in both falling and rising markets, consumers are much more constrained in their policies in the short term. In the long term, however, the balance of power tends to shift in favour of consumers who can pursue oil substitution policies, implement efficiency measures, raise taxes on petroleum products, and encourage the development of alternative energy sources which have the effect of reducing long-term oil demand and the share of oil in the energy mix.

Thus, an important role for the consumer-producer dialogue is to bridge the gap between the long-term and short-term interests of consumers and producers in order to create a more predictable and stable oil market. Recently, there has been a realisation that too low or too high oil prices serve none of the groups and that “oil prices should be at levels that are acceptable to producers and consumers to ensure global economic growth, particularly in developing countries” without any indication of what these levels should be.

Does the failure to bargain about price levels or to manage the price level within bounds mean that the producer-consumer dialogue has failed? The answer is no. Since both sides agree that the oil price should be set by market forces, the producer-consumer dialogue has aimed at improving the functioning of the market by promoting better understanding of the links between the financial and physical layers of the oil market and whether regulation is needed to improve market transparency. The IEF has also been showing a willingness to engage with the issue of stabilising short- and long-term expectations through better mutual understanding of oil market conditions and communicating to the market. In the Cancun Ministerial Declaration in Mexico in March 2010, producers and consumers noted for the first time the importance of stabilising expectations, recommending that the IEF should “disseminate key information related to marginal cost, investment levels,

and alternative energy sources that could help stabilise short and long-term expectations” and “act as the forum through which a better mutual understanding of views is communicated to the market”.

The supply disruption caused by the first Gulf War in 1990-1991 proved to be decisive for the producer-consumer dialogue, as it increased the awareness of common interests among parties and revealed the usefulness of coordinating actions in key areas such as the use of stocks and spare capacity. Disruptions, however, did not feature prominently in the dialogue during most of the 1990s. The availability of large spare capacity and the willingness of OPEC to fill the gap in the case of physical disruptions meant that concerns about disruptions received little priority in the policy agendas of consuming countries. The rapid rise in demand in the mid-2000s and the various supply shocks in producing countries such as Iraq, Venezuela, Nigeria and recently Libya brought back to the fore the issue of spare capacity and its role in dampening price volatility. Despite its rise in importance on the policy agenda, producers and consumers shied away from the issue for a long time. It was not until the Jeddah meeting in 2008 that specific calls were made for the expansion of spare capacity, with the acknowledgement that maintaining spare capacity is the responsibility of consumers as well as producers and consumers and extending to the entire supply chain, not just upstream players.

However, there are complex issues surrounding spare capacity: Does spare capacity constitute a public good? If it does, should all parties share the cost of maintaining spare capacity? If spare capacity is to be held in producing countries, can consuming countries find acceptable mechanisms to compensate producing countries? In such a system, who makes the decision to release the supply from existing capacity? These issues have not been addressed by the dialogue. As a result, policies on whether to maintain spare capacity and at what levels are solely set by individual governments with no coordination even between producing countries.

Rather than focusing on geopolitically-induced disruptions, the dialogue has shifted towards potential disruptions caused by the lack of investment in the oil supply chain. The investment issue has been a recurring theme in most Ministerial meetings. One of the important achievements of the dialogue in this area has been the increasing awareness that investment in the entire oil and gas chain is a shared responsibility between producers

and consumers. Nevertheless, the fact remains that the decision to develop reserves in producing countries is mainly in the hand of their governments and the NOCs, and none of the producers wish to relinquish this sovereign decision either through discussion or agreements between producing countries or between producing and consuming countries. As a result of the wave of mergers in the 1990s, many investments in upstream and in refining are now in the hands of privately-owned oil companies in various consuming countries where governments' influence is mainly in the area of regulation. Recognising this asymmetry, the producer-consumer dialogue has never attempted to coordinate investment plans. Instead, it has explored ways to remove impediments to investment in the oil sector.

The basic message of the dialogue has been the importance of adequate investment, aided by "favourable energy, fiscal, investment and environmental relations" which "are needed for freer and expanded trade in oil and gas and for sustainable world economic growth". The IEF agenda has broadened to discuss specific measures that can induce investment in the energy sector, such as reducing long-term uncertainty through public information on investment plans, energy security and climate change policies and their potential impact on demand, enhancing the cooperation between NOCs, IOCs and Service Companies, and broadening cooperation and exchanges in the fields of human capital and technology advancement and many other measures.

In the last decade both sides in the dialogue have tended to avoid such confrontational topics as green taxes and the financing of spare capacity, and have focused more on themes that can bring them closer together. There is a long-run risk of the key issues that lie at the heart of consumers' and producers' concerns becoming marginalised, leading to a loss of interest in the dialogue. Furthermore, while the dialogue in the 2000s has resulted in greater understanding of the nature of the investment problem and appreciation of the individual sides' point of view, concrete initiatives and proposals to alleviate the investment

problem have remained limited. The Libyan disruption in 2011 put serious strains on consumer-producer and producer-producer relations. OPEC members were not able to reach a consensus on increasing output in response to the Libya's output loss while the IEA's release of strategic stocks was not part of a coordinated effort between key producers and consumers. Consequently, the signals sent to the market were weak and confusing and created the perception that producer-consumer relations cannot be relied upon to smooth the oil market's adjustment to disruptions, unlike the supply disruption of the first Gulf War which proved to be the turning point for producer-consumer cooperation.

The dialogue has already reached many milestones. Consumers and producers have overcome some of their past myths, fears and suspicions and have become more aware of a number of common challenges related to energy markets. The institutional structure supporting the dialogue continues to strengthen; the structure and quality of the dialogue have also improved over the years. Nevertheless, many challenges remain. The way in which producers and consumers express their interests, to what extent they are willing to engage in issues that lie at the heart of their energy concerns, and whether they succeed in relating these energy issues to the wider context of political, economic and social security and the climate change challenge will define the future path of the dialogue. ■



THE IEF IS EXTENDING ITS OIL DATA TRANSPARENCY WORK INTO OTHER ENERGY AREAS