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## Energy Security: Rethinking Market and Governance



*Alleged market failures and the abuse or overuse of governance have shown that energy security could no longer be sufficiently ensured by working with the market or governance alone. Recent global concerns over environmental consequences of energy use have strengthened the imperative of proper and adequate market governance in ensuring energy security.*

by **Youngho Chang and Collin Koh**



THE PRIMARY goal of energy security has traditionally been to secure access to adequate, reliable and affordable energy supplies. However, concerns over climate change and related energy issues present a challenge in ensuring energy security. Alleged market failures, such as the Chad-Cameroon oil pipeline project, and abuse of governance, such as the renationalization of oil reserves in Venezuela, showed that market and governance alone are not enough to ensure energy security. There are pitfalls in depending solely on market or governance.

### **Pitfalls of Market and Governance**

Since the end of the Cold War, the state was no longer perceived as a principal provider of public goods. Riding on the wave of globalization and free market principles, the provision of energy-related public goods has become increasingly dependent on the private sector. Market liberalization is pursued to secure the delivery of competitively-priced energy resources. However, government intervention remains crucial in mitigating negative market externalities.

During the 1973 oil crisis, inadequate government intervention and blind reliance on market principles to secure foreign oil supplies contributed to the public rush for consumer goods in Japan. The Chad-Cameroon oil pipeline project in 2000 allegedly benefited only profit-seeking foreign investors in the absence of local government regulations to protect citizens' rights and the environment.

There are also governments that abuse or overuse their monopolistic power over providing energy-related public goods. The average citizen is arguably the most severely affected when governance is abused. For instance, the military junta in Myanmar purportedly exploited energy revenues to fund grandiose projects and weapon acquisitions while the population at large remains in abject poverty, not to forget also the reported environmental degradation caused by the Burmese-Thai Yadana gas pipeline project.

Venezuela could serve as an example of the overuse of governance in which Hugo Chavez, its president, curtailed foreign investments in the country's renationalized oil reserves, hence restricting foreign access and enabling the use of oil as a tool for furthering geopolitical interests. Lately, President Chavez allegedly wanted to sever oil supplies to the United States against the backdrop of deteriorating bilateral relations.

The examples highlighted above show that the use of markets alone without proper government oversight would open energy security to abuse by profit-seeking individuals or companies. Vesting energy security totally in the hands of the government might lead to its abuse for use as a political tool, taking Venezuela's recent threat to sever oil supplies to the US for instance. Hence, a combined approach fusing the market with governance is required to ensure energy security and to meet rising energy demands as well as combating related issues such as climate change.

### **Market Governance and Energy Security**

Geopolitical upheavals such as the diplomatic tussle over the alleged Iranian nuclear weapons programme have contributed to price and supply volatility of energy resources. The global community is also faced with the urgent need to combat global warming that would have dire consequences for the ecosystem. These issues make the search for alternative energy sources and ways to reduce energy consumption increasingly more important in order to ensure energy security in the long term.

The approach of combining the market with governance, in the form of market governance, could serve as a psychological assurance to energy investors and consumers. They might otherwise lose confidence in the face of uncertainties, such as price and supply volatility, within the global energy market. Good market governance could be defined as the best set of all laws, regulations, processes and practices that affect the functioning of a regulatory framework and the market.

Its basic tenets of transparency, accountability, flexibility and respect for competition principles, among others, could provide an environment conducive for investments in long-term technological solutions to energy security problems. In particular, good market governance would benefit the increasingly important small- and medium-sized enterprises which occupy specialist niches on innovative energy-efficiency and alternative energy solutions.

The Japanese example during the oil crises in the 1970s demonstrates an approach in which both market and governance are weaved together to ensure energy security. During the second oil crisis in 1979 there had been no panic rush in Japan for consumer goods reminiscent of 1973. Similarly, in the immediate aftermath of the Iraqi invasion of Kuwait and the Coalition military buildup prior to Operation Desert Storm in 1990, Japanese energy investors in the Middle East remained optimistic despite an anticipated, but never materialized, oil crisis.

This could be attributed to the post-1973 policies adopted by the Japanese government, such as energy-saving measures and guidelines defining public-private relationship with respect to investments in energy efficiency and alternative energy technologies.

Notwithstanding the failure to agree on numerical carbon-emission limits during the recent G-8 Summit, there has been increasing worldwide interest in reinvigorating the governmental role, in conjunction with the market approach, towards addressing energy security issues. For instance, in February 2008 the European Commission has been championing for an independent body that amalgamates member states' national energy regulators. Member representatives had called for this European agency to be equipped with powers to solve cross-border energy issues and take rapid and binding decisions when required in order to regulate the energy market.

Earlier in 2006, there were calls in Thailand for an independent power regulator prior to privatizing the Electrical Generating Authority of Thailand. The United States Federal Energy Regulatory Commission (FERC) adopted new guidelines in 2007 to enhance accountability among market operators and hence promote competition. These examples appeared to balance the market and governance approaches, thus highlighting the growing recognition that good market governance is a key ingredient for ensuring energy security.

## **The Way Forward**

Energy security is concerned not only with ensuring the continuous supply of fossil fuels at affordable and/or reasonable prices but also about combating climate change. Curbing energy consumption through energy efficiency and alternative energy technologies would be the long term solutions for the security of energy supply and mitigating the harmful environmental effects of global warming.

However, the use of the market or governance approach alone – prone to abuse and overuse by self-interested commercial and political actors – would not be able to address these energy security issues. Proper and adequate market governance promoting transparency, accountability and respect for competition principles could sow optimism and confidence for investors and consumers. This would encourage investments in finding long-term solutions to energy security problems.

A stable socio-political environment is another essential factor for encouraging and retaining energy-related investments. Last but not least, steps taken by some countries, such as the US through the FERC, to promote accountability and independent market supervision must have constituted the right direction towards good market governance.

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