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## The New Political and Business Risk Dynamics

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### Abstract

This paper argues that the international oil and gas industry is currently experiencing a shift in the nature or pattern of political and business risks facing companies with foreign interests or operations. The shift is being driven by a variety of political and economic factors – the emergence of national oil companies as exploration companies; new and different geopolitical linkages between producers, and producers and consumers; the heightened possibility of terrorist acts targeting unprotected oil industry facilities; increased state participation and nationalism; and the reemergence of the so-called “energy weapon” in the form of nationalizations, changes in terms or supply restrictions. Thus, a change in oil industry-specific political risk assessment may be in order.<sup>1</sup>

### Introduction

In 1911, Winston Churchill, First Lord of the Admiralty, made the fateful decision to convert the British Navy's source of fuel from coal to crude oil. In doing so, he forever linked the industrialized world to the oil supplies in the Middle East and elsewhere, and paved the way for the emergence of crude oil as a strategic resource.<sup>2</sup> Thus, the quest for the control, ownership and utilization of crude oil – what Daniel Yergin famously identified in his Pulitzer Prize-winning book as “the prize” – has always been, at a certain decisive level, as much political as economic and has had broader political and geopolitical implications.<sup>3</sup> Yet it was not until after the 1973 Arab oil embargo and around the time of the Iranian Revolution in 1979 that oil exploration companies began incorporating political or business risk assessments into their long-term planning exercises.

The very first efforts at political risk assessment by oil companies and other practitioners in the field focused primarily on identifying the probability of macro-level disturbances (war, regime changes, internal violence, etc.) in lesser-developed and newly-industrialized countries that might

lead to the interruption of operations, destruction of facilities or the nationalization or confiscation of company interests. This was an understandable response to various incidents of political unrest in oil producing countries and a rash of expropriations of petroleum sector interests that took place between 1960 and 1976.

However, beginning in the mid-to-late 1980s the relationship between foreign operators and host-country governments gradually changed. Governments once hostile to foreign oil companies came to realize that antagonistic, uncompensated takeovers severed ties to the funds, expertise and technology needed to sustain expansion of the petroleum sector and secure economic growth. Moreover, there was a general trend toward favoring free-market economics and liberalizing petroleum legislation to make exploration more economically attractive to foreign companies. So long as the chances for a discovery were good, access to markets remained open, and acceptable fiscal terms guaranteed an acceptable rate of return on investment, exploration companies found that they were able to work almost anywhere in the world – including the former Soviet Union, which offered vast new areas for exploration and foreign investment. And, as the oil industry and the risks at hand changed, so too did the focus of political risk assessments in the international oil and gas industry. Expropriations and nationalizations were viewed as a thing of the past, and political risk analyses tended to focus on shifts in legislation and policies, the possibility of intermittent operations/production disruptions caused by civil unrest or low-level political violence and changes in political leadership.<sup>4</sup>

Yet, while the oil and gas industry and the practice of industry-specific political risk analysis changed to a certain degree over time, from the late 1970s through the 1980s and even 1990s, some things remained very much the same: major oil companies were still the key players; crude oil, not natural gas or some other energy source, was still the king; energy security continued to be defined as “the availability of sufficient supplies at affordable prices”;<sup>5</sup> and political risk assessments continued to focus almost exclusively on individual countries and host-country risks. But now things are seemingly different. The thesis of this paper is that the competitive landscape of the international oil and gas industry has changed once again, and that there has been an associated change in the nature or pattern of political and business risks facing companies with foreign interests or operations. This change in the configuration of risks currently facing international oil companies is being driven by higher crude oil