Brussels Beijing Bet

By Matthew Hulbert*

The Libyan fracas has been a major wakeup call for anyone thinking Europe had morphed into being a serious geopolitical actor. What's less obvious is that Tripoli's toils will have a serious impact on the upstream energy landscape across Europe. That's not just because Europe lost 1.5mb/d of sweet oil production making its way across the Mediterranean and around 16% of EU15 gas – but because the West, and more notably NATO, has shown its weakened energy hand. The Alliance can't provide the necessary security blanket for European political incentives to play out across adjacent oil producing states. That clearly goes for North Africa, and even more concretely for the Middle East and Central Asia – two of Europe's supposed four energy 'corridors' Brussels was attempting to open up. The idea was, of course, a good one: diversify supplies in order to reduce structural dependence on Russian gas in terms of volume and price. But the execution has been lousy. European military indecision will ironically result in far greater dependence on Russian hydrocarbons, precisely because the security seal is too politically leaky for upstream producers to take Europe seriously. From Brussels to Berlin, Paris to Prague, Europe has no real choice but to go 'long' on Moscow to secure its vital oil and gas supplies.

The crux of Europe's problem starts in America, of course. The U.S. is no longer willing to stand guarantor for European energy interests. As Secretary of Defence Robert Gates put it, Libya is 'not a vital interest to the U.S.' and Washington has treated it accordingly. Energy independence is back in DC fashion, which means Europe will be left to settle its own energy scores. So, time for a fundamental European rethink on energy policy and security? Yes. Not unless Europe really wants to try and go it alone. But fundamental must mean fundamental, which requires looking towards China. Instead of trying to politically attract producer states by offering a security and political presence the EU can't provide, Brussels should work from the demand side of the pipeline: most notably with Beijing. That's how a strategic energy policy could be forged, through an 'ASEUN' Asian-EU consumer partnership, not relying on the broken security architectures of old.

NATO – Cart and Horse

If NATO was going to get serious about energy provision, it only ever had one role to fulfil: to be seen as a credible source of security for producer states sitting aside European borders (and in some cases, beyond) to let political and commercial games play out towards European markets. That meant providing 'negative' security incentives to keep producer regimes on the political straight and narrow, or indeed offering positive security pulls for producers willing to look beyond their traditional external mentors. For upstream players in Central Asia, the Gulf and Maghreb, security issues really do matter.

Obviously blame can't just sit on NATO's shoulders. Governance small talk from the EU hasn't exactly helped in the rough and tumble energy world. If Europe really wanted serious upstream supply agreements in Central Asia and the Middle East they were trading the wrong currency. Democracy and human rights – no. Solid security guarantees and handsome commercial agreements – yes. That's the main 'swap agreement' oil producers have traded in decades past, and it's the one (for better or worse) that they still regard as legal tender.

That probably sounds brutal to some, but ask the simple question: Why has China been able to break the Russian mould in Central Asia opening up oil and gas pipelines from Kazakhstan, Uzbekistan and Turkmenistan? Why has Beijing turned the Middle East into a 'Chimerican lake' of ebbing U.S. power and increased Chinese oil flows? Governance reform wasn't part of the pitch: Political certainty from growing Chinese economic influence and power was - both on a bilateral and regional (Shanghai Cooperation Organization) basis. It's the only reason Central Asian leaders dared to go against Moscow's long held strategy of monopolising Eurasia supplies for (re)export purposes. It's also the only reason the Gulf States are happy to look for a plan B beyond U.S. demand and U.S. military supply. Asia is the obvious option.

Consumers – Not Producers

The logical conclusion is that Europe is never going to cut the mustard getting producer states onboard without a revolution in upstream acquisition – the latest Commission penchant to construct a Trans-Caspian Pipeline between Turkmenistan and Azerbaijan to feed Europe markets will no doubt provide the latest example of such flops. The logic is clear; stop trying to get producers onside in an increasingly competitive and nasty upstream game that Europe is incapable of

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playing, and start aligning your interests with the major energy consumer of tomorrow: China. That's how pressure will be applied in producer states, by forming a credible consumer consensus safeguarding demand side interests; not hoping and wishing that producers will magically fall into political and commercial line to enhance European supply. Just as China has taken a free ride on U.S. security cover over the past decade, it's time for Europe to play smart and free ride China – at least in the political realm.

Many will argue 'nonsense'; Europe should still look to the U.S. to reinvigorate NATO and provide the political clout Brussels needs to open up new energy supplies. This is an argument that used to have merit. Washington has long taken European energy supplies far more seriously than Europe has. It's the only reason the BTC pipeline was built, and why fresh Central Asian and Middle Eastern supplies have ever prospectively been raised. But that was then, this is now; America is understandably adopting an increasingly 'isolationist' energy policy. It's floating on a bed of unconventional gas production; it can see massive potential in Canadian tar sand production, and will increasingly open up its own offshore projects to enhance security of supply while drawing on Latin American output. The furthest Washington is likely to go looking for oil is Western Africa these days, primarily because it sits directly over the pond – 'geopolitical dredging' will not be required.

As for the 'Broader' Middle East, it's not really been about consuming the bulk of Gulf oil for some time now in the U.S. It was about ensuring the safe flow of hydrocarbons to global markets in the East and West as the geo-economic and geopolitical lynchpin of the world - a role that America is no longer fully willing, or indeed able, to perform. If Libya has shown the true costs of the Iraq war in terms of depleted U.S. political capital, then Tripoli (and associated regional turmoil) will probably play out through dwindling U.S. clout in Iran, Iraq, Syria and Turkey; not to mention the Gulf. Washington has not just been a political bystander in the Arab Spring, but something of a military 'prisoner'. China holds the U.S. pursue strings across the board, which means that Beijing will ultimately decide how much America can and can't spend on defence, and how long it can perform a global military role. Default will be logical outcome should the U.S. fail to understand this dynamic.

That leaves Europe in a very difficult energy position. It was always assumed the U.S. would stand guarantor of European energy interests, but it's increasingly clear the U.S. will slowly drop out of the Eurasian energy game. No U.S. = no serious security cover to reassure producers that exporting West towards Europe is a politically smart thing to do – either in Central Asia or the Middle East. Hence it's time for NATO to stop talking about energy security and start facilitating a serious discussion as to how Europe can politically position itself for a robust energy future. That means putting 'politics' back into energy supplies and taking 'security' out – if we keep pretending the latter is a serious option, it won't just make Europe look internationally incredulous, it will seriously impede negotiations with China towards a more effective 'ASEUN' energy policy. Like it or not, Beijing is Europe's best energy bet should consumers want to secure mutually vested interests. Getting Chinese blessing and Chinese support for European initiatives will be crucial to re-establishing a European stake in the energy world.

Look at the Map

Tabling an 'ASEUN' club is where things would get interesting, of course. The core argument is that 'arbitrage' (commercial and political) works one of two ways – either in favour of producers or consumers. Rarely do both sides get what they want. Rarely do producer-consumer interests align. We know that producers have a strong record of cooperation (OPEC is one example), GASPEC might one day be another. We also know that consumer cooperation tends to be feeble – the IEA can't yet boast India or China amongst its ranks. But assuming that consumers want stable supplies, stable prices and a broad diversity of supply, it's clear that Europe could gain considerably through enhanced co-operation with China, particularly as both consumers will need to heavily draw on Russian hydrocarbon reserves in the future. Just take a brief look at the map and it's clear that Moscow sits at the geographical heart of the Brussels-Beijing energy relationship.

Not surprisingly, China is already ahead of the European game – and massively so. Despite all the headlines about Chinese forays in Africa and further afield in Latin America, Beijing has been very smart to diversify its supply options closer to home – both from the Middle East and Central Asia in order to counterbalance and hedge political and price risks involved. Contractual relations with China have been remarkably stable as a result. Chinese 'ownership' of South East Asia and Australasia helps in this respect, of course, but if Central Asia and the Middle East constitute China's 'energy belt', and Africa and Latin America provide the 'secondary braces', it's clear that Beijing deems that nothing short of an iron clad 'belt and braces' approach is needed to nail down its other major future source of Eurasian supply, Russia.

The fact that China has only belatedly brought the 1.6bn/d ESPO oil pipeline to fruition from Russia's East with a tentative memorandum of understanding between CNPC and Gazprom in place for gas, tells us two things. The first is that China doesn't trust Russia on price (hence some of the long project delays), the second is that China will only really look to Russian supplies once it has a sufficiently strong position in Central Asia and the Gulf to keep Moscow on the straight and narrow. Unlike Europe, China is well aware that Russia would like nothing more than to feed European and Chinese markets to maximise political and economic rents between East and West, while maintaining its historic stranglehold on Central Asian supplies.

Fortunately for Europe, that's logistically very tricky for Russia to pull off, and more importantly, it's a game Beijing is not about to play – it will strive to conduct price and politics over Moscow on China's terms, and indeed towards other MENA and Central Asian producers in turn. But the key difference is that China has worked hard to prevent dependence on any one producer state. Europe is rapidly heading in the other direction. Not only has it lost its security credentials, it hasn't gained upstream supply agreements in Central Asia; it hasn't cemented its MENA position, or indeed considered bilateral price collusion implications that Gazprom's creeping internationalisation strategy could entail. That's all while Europe's industrial giant, Germany, refuses to contemplate the energy (in)security that the Russo-German 'NordStream' pipeline will create for Eastern Europe - or what kind of implications its recent nuclear phase out will have. The proposed merger between RWE and Gazprom should provide a pretty good idea given it will wipe out RWE's support for the Nabucco pipeline as well. The Russian inspired South Stream pipeline will gain ground as a result. Left to Berlin – let alone Brussels, Russian arbitrage would become a self fulfilling prophecy between East and West. China is the only factor preventing this overall outcome, but that's by no means sufficient to prevent structural European supply dependency on Russia at our end of the pipeline.

China's Call – Deals for Everyone?

Assuming Europe is brave enough to float the ASEUN idea, would China go for it? Beijing is well placed to leverage multiple producers to its own ends, irrespective of consumer co-operation with Europe. China could go on snapping up the bulk of new supplies wherever they crop up, leaving the old energy world in its wake. A case of 'your supply', 'your problem'? Perhaps; but China is nothing if not strategic. (In)formal consumer cooperation with Europe could have benefits for the Middle Kingdom, and here's why:

If China made clear to Central Asian producers that it had no problem with Europe taking a seat at the table, and would actually find it desirable for some supplies to head West, this would help 'triangulate' the Great Game. It's clearly not in China's interests to see Central Asian supplies being boiled down to a two way Sino-Soviet power play, Beijing would have nobody to third party its tussles to. More importantly, letting Europe in on the Central Asia act would give the EU a far freer hand when dealing with Russia. And it's Moscow that really matters for China in terms of future Eurasian volume and bulk. If Russia gets Europe over the barrel, Moscow would inevitably try and use this as collateral to squeeze a little tighter on Sino-Soviet energy relations at some stage. That's irrespective of how well covered China thinks it might be in terms of exclusive access to Eastern Siberian fields. ASEUN would not only enhance European and Chinese interests over Russia, it would ensure that more players could balance the overall risk in Central Asia by reducing the prospects of price collusion between Russia and Central Asian producers.

Likewise in the MENA region – encouraging key producers to feed European markets rather than purely heading East has merit. The same elasticity of supply arguments clipping Russian (and Central Asian) wings apply – which in turn would hedge Russian and Central Asian bargaining positions against those of the Gulf. Just as importantly, it's in everyone's geopolitical interests to get Europe back into the MENA game. As it stands, geopolitical frictions in the region are becoming a binary U.S.-Sino option as far as external powers are involved. Assuming the Arab flag will inexorably follow Chinese trade, the potential for miscalculation and misinterpretation between the U.S. and China is acute. If the U.S. takes assertive action to shore things up one day, it could easily be read as a last ditch power play in Beijing, rather than residual responsibilities to fill growing power gaps. Make Europe part of the overall equation, and U.S. decline would seem a natural evolution for a nation recalibrating its global footprint and interests, not a dramatic East of Suez moment. MENA states would also feel more comfortable feeding European markets alongside those in the East. They get healthy premiums on the sweet grades produced in North Africa shipped across the Mediterranean, and it goes without saying that LNG heavyweights such as Qatar, should never put their supply side eggs in a single demand side basket.

The obvious quid pro quo for Washington would be a freer hand to cement its energy position in the Americas – chips that Beijing would be happy to trade in places like Venezuela if it held the energy whip hand in the Middle East. China would also be less precious about West African supplies going over the pond, at least if Beijing had first dibs on any new finds in East Africa and the Indian Ocean. The overall logic is, therefore, clear. Europe has utility for China and vice-a-versa in the Middle East, with the added bonus that eventual U.S. departure from the Gulf would be more valedictory in nature than cataclysmic.

Know Your Place

But for any of this to work, Europe needs to understand that it is the junior partner. That shouldn't be too hard considering that China will increasingly backstop the European economy in years to come. Debt, foreign investment flows and demand will all emanate from Asian shores. And yes, that will come with political strings attached as far as Chinese trade, currency and arms issues are concerned. He who pays the piper ultimately calls the tune, which directly links to the fact that Europe must understand that the U.S. security umbrella is only going to shrink from hereon in. A political strategy to engage China on energy issues isn't a mere policy option, it's now an absolute imperative. Thinking Europe can cling onto the U.S. and magically jump towards China at a time of its choosing isn't just strategically stupid, it would seriously impair energy interests in the short to medium term. Assuming India would act as some kind of proxy for Western energy interests against China is similarly dud thinking. If anything, Delhi is transfixed with how to improve energy relations with Beijing, not sever them.

And that's really the whole point here: energy security is no longer achieved through military dominance, naval force projections or even boots on the ground. For Europe, energy security depends on its ability to exploit Chinese influence in Central Asia as a hedge against Russia, while working toward a consumer-driven market to enhance security of supply from the Middle East and beyond. Europe so far only has the imagination to try and talk to its prospective suppliers, not work hand in hand with consumers at the other end of the pipeline. This will, of course, mean accepting Beijing's commercial rules in return for political support if it does so, a ride that any consumer state should consider taking. U.S. security cover is rapidly shrinking; Chinese commercial clout is growing. NATO has run its energy course. The Libyan debacle now has the trappings of a European silver lining, but it will only stick on the energy front if Brussels accepts that it has to turn to the East to tackle the EU's energy dilemma. That means trading supposedly 'guaranteed' returns of European 'security' for the potential gains of Sino politics. A strategic shift that is certainly as bold, as it might one day prove necessary.