

Foreign Voices



No. 4
November 2006

Energy & Geopolitics

A European and a Chinese Perspective

In this issue of the Foreign Voices, the geopolitical implications of the growing demand for energy resources is discussed from a European and Chinese perspective by Jacques de Jong from Clingendael International Energy Programme (CIEP), an advisor to the Dutch government, and Dr Xuanli Liao from the University of Dundee. As the issue of access to resources gains more and more importance, the question is how governments will react to this situation. Both authors were speakers at the first expert workshop of a new project series on "Global Resource Management" organized by the Development and Peace Foundation in cooperation with the Federal College for Security Studies (BAKS), Berlin, and the Wuppertal Institute for Climate, Environment and Energy.

Jacques de Jong

Clingendael International Energy Programme,
The Hague, Netherlands

**"Hydrocarbon molecules are increasingly
asked for their passports"**



Meeting EU Energy needs is a basic condition for sustaining EU economic growth. With energy efficiency increasing and energy intensity declining, EU energy needs are still forecasted to rise quite substantial. EU figures are indicating a rise in primary energy demand from some 1,750 million tons (mts) to almost 1,900 in 2030. Energy balances will continue to be largely based on oil and gas (some 60%), with coal, uranium and renewables covering basically equal shares. The next 25 years will see dramatic changes in EU energy import dependency, concentrating on oil and gas. With overall ener-

gy import dependency rising from today's 50% to some 65% in 2030, oil and gas demand will need to be covered by imports by around 90% in 2030.

These developments are exemplary of the global energy picture. The world at large faces similar developments, with oil and gas covering some 60% of world wide energy growth. These fuel dependencies are increasing public and political awareness about oil and gas resources. Global views expressed in the expert community are putting proven oil reserves at some 1,200 billion barrels, able to sustain present production levels for some 40 years. Figures for gas are 180 trillion cubic meters, covering more than 60 years of present production. More oil and gas is to be found and technology development will continue as well. Resources are not the issue, but access is.

Oil and gas resources are increasingly geographically concentrated. For oil this is basically the MENA-region (Middle East/North Africa) with some 60%. For gas Russia has to be added to MENA, covering some 75% of world resources. As resources are concentrated in a handful of countries, their national state owned oil and gas companies are controlling some 90% of total reserves. These facts are bringing access-issues to the front. Oil and gas flows to world markets, with a small number of vulnerable transport choke points adding to supply security risks, will therefore increasingly be subject to producer government policies.

New performers in the energy theatres

Globally however, the OECD world will face a strong decline in its share in the "energy pie" from its present 50% to some 40% in 2030. The developing world, with China and India as the main drivers, will see their shares growing from today's 40 to almost 50% in 2030. We are also noting a growing role for the Asian oil and gas industry, with strong backing from their governments, or even some direct involvement. In this global context, questions are asked whether the prevailing paradigm of multilateral frameworks and market driven strategies will stand in the medium to longer terms. A paradigm shift towards more bilateral and state driven mechanisms may be emerging and gaining further momentum in setting the rules for global oil and gas supply and demand relations.

These patterns are further affected by political instability in the MENA-region, together with its ongoing conflicts and wider security threats. In such a world, geopolitical issues will be strong drivers for governments in securing their energy needs. Although the major international oil companies and global oil and gas markets will still play large roles, hydrocarbon molecules are increasingly asked for their passports. China and India, Japan and Korea, as well as Latin American countries are not the only players in energy theatres. We increasingly see performances from the US, from Russia and from some of the larger European countries as well. From the front or the back, governments are coming back on energy stream, determining largely whether or not multilateral or bilateral frameworks will prevail and whether economic efficiency and competition or foreign policy issues will set the rules. It is in this context that the world may move in the direction of "Markets & Institutions" or "Regions & Empires". The EU as the world's largest global economy has to determine its role, its vision and its strategy, covering both types of futures.

The EU with its 25 member states has a volatile record in formulating and applying its role in the global world economy. The EU Treaties, although based on bold visions with respect to political and democratic stability through market integration and economic trade and competition, failed to achieve an integrated approach for EU energy policy. Noting that coal & steel with the ECSC-Treaty were the precursors of the wider EU project, with uranium and the Euratom Treaty as a very interesting add-on, the role

of oil in the wider energy mix, later followed by gas, prevented national governments and their energy industry interests to agree on wider and overall EU energy policy approaches. Attempts to strengthen the EU's legal basis on this point have failed so far.

The EU did succeed however in establishing an overall legal framework for its internal energy market, creating the world's largest energy market by opening its electricity and gas markets, and allowing market forces to play their game under coordinated EU regulatory oversight. This internal orientation however has so far failed to accommodate the emerging external supply security concerns, notably on gas. On the energy/environmental issue, the EU was rather successful as well in establishing a cap-and-trade system for carbon emissions and in embarking on a number of programs for promoting energy efficiency and energy renewables. These two success lines however lacked mutual cohesion and consistency, which became the more apparent when the energy supply security issue was again climbing the policy charts.

Overall EU energy policy vision still missing

Energy supply security events in 2005 and 2006 did increase political awareness in energy policy issues, gaining political momentum with new initiatives and approaches. The 2006 Russia-Ukraine gas-incident presented even an almost serendipian opportunity for the EU machinery to set its energy policy records straight. The EU Commission announced an EU-wide consultation on the basis of a new Green paper, "Fuelling our Energy Future" and announcing numerous new initiatives to come later in 2006 or early 2007. The European Council basically agreed with the Commission's approach and planned to have a full discussion on the energy issue at its Spring 2007 meeting. In addition, Germany, combining both the EU and G8 presidency, indicated already to put EU energy policy on its agendas.

Will the EU deliver, will it meet the high expectations? Will we see an integrated EU energy policy, based on a visionary approach and strategy in line with EU traditions and records from the early 1950's? The recent Green Paper makes an effort, but lacks the necessary vision and ambition. Although tone and approach are less Eurocentric as they used to be, and are more open to the EU's main trading partners, the Paper still lacks the strategic and integrated approach that a comprehensive EU energy policy would need. A number of individual issues and initiatives, basically with respect to the internal energy market, are rightly addressed, but are failing to make a coherent case for national capitals to go for an all-out European approach. The idea to come with an annual Strategic Energy Review however looks promising, but the paper is on the other hand really disappointing on external energy relations policy.

Accepting that sustaining EU energy supply security requires an EU external energy policy with due regard to geopolitical developments may look evident for many energy policy watchers. Political agendas in national capitals however are giving different signals. Concerns about national energy champions or EU champions-to-be is such a signal. Other signals seem to concentrate on bilateral energy relations with Russia or on mixed feelings about the future EU Convention where common political views are seeking a strong EU energy policy. Realising that the EU had always difficulties in the past to combine a strong internal economic policy agenda with organising a coherent and effective external approach, the energy issue is not unique. Remembering that the EU has also a record of moving on such issues solely when there is severe external pressure or even a crisis situation could give some hope for EU and national energy policy futures.

Dr Xuanli Liao

Lecturer in International Relations and Energy Security,
Centre for Energy, Petroleum and Mineral Law and Policy
(CEPMLP), University of Dundee, Scotland, UK

**"Chinese oil companies are not in a position to compete with international oil majors"**

Geopolitics has always been an important concept in Chinese diplomacy, but it has never been so closely linked to energy security as it is today. Following its rapid economic development over the past couple of decades, China can no longer provide sufficient oil supplies on its own. In 1996, when the country became the net importer of crude oil, China imported less than 23 million tons (mts) annually, but this figure went more than five times higher within ten years to 127 mts in 2005, and may grow further to 270-430 mts per year by 2020, counting for 60-70 percent of China's total oil consumption, according to China's National Development and Reform Commission. Faced with the serious situation on energy security, the Chinese government has pursued "energy diplomacy" to replace its "economic diplomacy" which was initiated from the late 1970s.

Like most of the oil consumers, China's oil supply is highly reliant on some main oil producing regions, such as the Middle East (47.2%), Africa (30.3%), and Russia (10.1%). However, the concerns behind China's international energy strategy have undergone noticeable changes over time, with geopolitics playing an increasingly greater role in the process.

When China first went overseas in search for oil in the late 1990s, its focus was on the geologically less distant "belt regions" - from North Africa to the Middle East, Central Asia and Russia, but the driving forces behind its energy strategy varied between different regions. In the Middle East, China used to focus on energy security and economic cooperation but took a passive stance in political affairs, probably relying on the United States to guarantee regional order and stability. In contrast, China's approach toward Central Asia was driven by geopolitics and national security concerns, and energy was virtually a tool to promote closer ties between China and the Central Asian countries. Beijing's energy cooperation with Russia was a combination of energy security and strategic concerns. The bilateral agreement on the Angarsk-Daqing oil pipeline, signed in September 2001, was not only viewed as serving their countries' interest in energy perspective, but also as possibly forming a new basis to support the Sino-Russian "strategic partnership". The project did not proceed well later partially due to Russia's domestic politics and partially due to the competition from the Japanese.

Energy security vs. global responsibility

With the continuing increase of China's oil imports, the new century witnessed a rapid expansion of Chinese oil explorations beyond the "belt regions", covering most of the continents of the world. China's turning into a global player in energy search, on the one hand, may help the country diversify its sources of oil supply and thus improve its energy security. On the other hand, however, China faces new challenges in its international energy strategy, involving more geopolitical elements than ever before.

The first challenge facing China is how to maintain the balance between its energy security and being a “responsible stakeholder” at the world stage. As a newcomer in the international oil market, Chinese oil companies are not in a position to compete with international oil majors in obtaining access to rich oil reserves. Instead, they often have to rely on smaller oil producers or to deal with “states of concern”, who are isolated by the international community. China’s marginal status in the international market can be observed from the table below: among the top ten oil suppliers to China, only three are top ten oil producers in the world.

Top 10 of China's Oil Suppliers

State and Region	Year	1999	2001	2005
Saudi Arabia		6.8%	14.6%	17.5%
Iran		9.6%	18.0%	11.2%
Oman		13.7%	13.5%	8.5%
Yemen		11.3%	3.8%	5.5%
Russia		1.5%	2.9%	10.1 %
Angola		7.8%	6.3%	13.7 %
Sudan		0.7%	8.3%	5.2%
Congo		1.0%	1.1%	4.4%
Equator Guinea		2.2%	3.6%	3.0%
Indonesia		10.8%	4.4%	3.2%

Indeed, some of China’s major oil suppliers, such as Iran and Sudan, are listed by the United States as “states of concern”, and China’s continuing dealing with them for oil supply has faced serious criticism from the US and its Western allies. In contrast to its strategies a decade ago, Beijing took a more active approach in responding to the criticism this time, to ensure its energy security. In dealing with the Iran nuclear crisis, for example, Beijing stood firmly with Russia resisting the US proposed sanctions against Iran, despite the shared interest with other major powers on nuclear non-proliferation. China held that its position was based on its foreign policy principle of taking “peaceful means” to solve international crises, but another part of the motivation could be China’s attempt to challenge the US hegemony in the Middle East, given the significance of the region for China’s energy security.

China’s energy and economic cooperation with Sudan started in 1995. These close ties have not been affected by Sudan’s poor record on human rights. China has, on the one hand, abstained from the resolutions of the United Nations Security Council for possible sanctions against Sudan, and on the other hand, insisted on the principle of “non-interference” in other countries’ internal affairs. Whilst Beijing has the right to decide what strategy to follow to reach energy security, it may also need to realise that such a strategy was at the risk of its international image as a responsible power. If China wants to be recognized as a “responsible stakeholder” by the international community, it will need to accommodate its foreign policy principles more closely with the international law in the 21st century. China has played a positive role in helping with the North Korean crisis, and it should be able to exert its influence on Sudan as well.

China’s intensive dealing with Africa in general has taken place fairly recently, partially to develop the continent into another important basis for oil supply. However, ener-

gy is not the only thing that Beijing is interested to obtain from the region. China's African diplomacy also aims to help "Africa grow and become stronger", as claimed by Chinese State Councillor Tang Jiaxuan, and to gain support from the countries for its leading role to represent the interests of "developing countries". In addition, to block Taiwan's "international space" is another important objective in Beijing's policy towards Africa.

The challenge of securing transit routes

The second challenge facing China is the safety of the sea-lanes for oil transportation. As suggested by the above table, amongst China's major oil suppliers, only Russia shares borderlines with China and thus can transport oil via either railways or pipelines. Therefore, China has attempted to strengthen its energy cooperation with both Central Asian countries and Russia, using the Shanghai Cooperation Organizations as an instrument. Oil from all other sources has to be transferred over long distances and through the Straits of Hormuz, Malacca and Taiwan. Given the weak navy forces China has got at the moment, to ensure the safety of the transportation route is a practical problem for China, especially in the case of an armed conflict with Taiwan. To overcome the problem, China has made great efforts in building up its "blue water navy" over the past two decades, but it does not see a real chance to compete with the US navy in the foreseeable future. Beijing has also reviewed other options to transport oil bypassing the Malacca and Taiwan Straits, such as building pipelines across the Isthmus of Kra in Thailand to the Gulf of Siam, or between Myanmar's Bengal to China's Yunnan, amongst others.

Of course, China's strategy on energy security may cause potential conflicts with other major powers, especially with its Asian neighbours. Beijing is already facing competition over energy and geopolitics from Japan, and to a less extent from India as well. Since there is a "lack of regional institutions to manage conflict" in East Asia, as held by Mikal Herberg, an expert on Asian energy security, China's rising can be a challenge to the region, and to Beijing itself. Equally, it can be an opportunity for Asia and the world as well, if energy security can be a vehicle to promote better regional cooperation.

It may be fair to say that China has realised its dream to re-emerge as a great power in the world – being the fourth largest economy, second largest oil consumer, and an important player in world geopolitics. However, that should not be the end of the story. To convince the world of its peaceful development, China needs to work harder to ensure peace and prosperity not only within China, but also in the world, together with other major powers.

Imprint

The **Development and Peace Foundation** is a cross-party, non-profit-making organisation which was founded in 1986 on the initiative of Willy Brandt. More information is available under: www.sef-bonn.org

Development and Peace Foundation
(Stiftung Entwicklung und Frieden - SEF)
Gotenstraße 152
D-53175 Bonn

Phone: +49 (228) 95925-0
Fax: +49 (228) 95925-99
Email: sef@sef-bonn.org

Bonn, November 2006

ISSN: 1862-3913