EUROPEAN

POLICYBRIEF

GLOBAL RE-ORDERING: EVOLUTION THROUGH EUROPEAN NETWORKS

GR:EEN
Global Re-ordering:
Evolution through European Networks

How does China's thirst for oil and gas impact on the EU's energy policies? The Africa and Central Asia test cases.

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INTRODUCTION

The rise in Asian countries' demand and consumption of energy has resulted in an almost parallel growth of their political and financial efforts to secure the imports to fulfill their domestic needs. China in particular – which in 2010 became the world's largest energy consumer – has made impressive investments in the oil and gas sectors of Africa and Central Asia, also engaging these areas with its increasingly active and effective diplomacy. China's pervasive presence and its capacity to become firmly entrenched in the energy sector appears to undermine the European efforts to gain an advantageous energy supply diversification. It is therefore necessary to get a clearer picture of China's presence in Africa and Central Asia, assessing the repercussions and the potential threats of this new set of conditions for the energy security of the EU.

EVIDENCE AND ANALYSIS

China and the African Energy Market

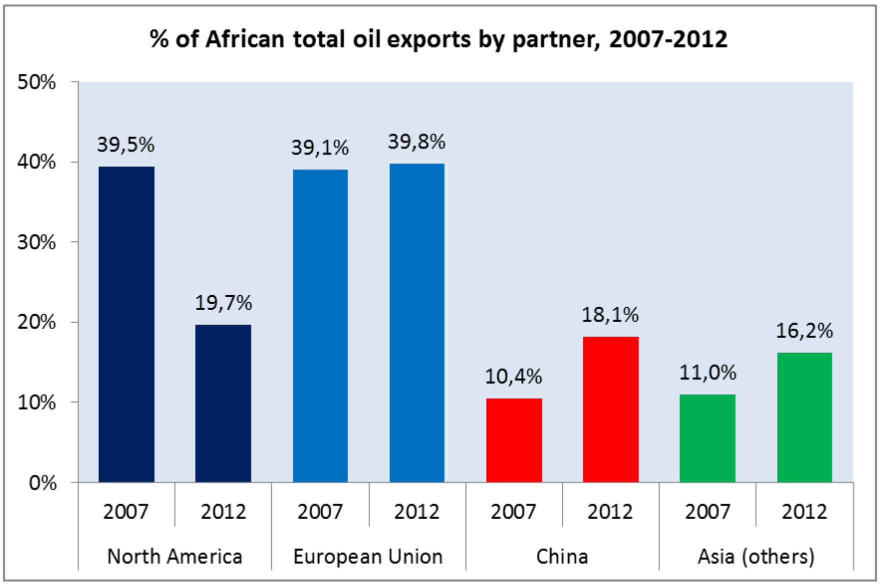
Since 2000, and more intensively since 2006, many Chinese companies have been landing in African countries, settling first in countries like Angola and Sudan, and then expanding into new and less conventional producers, targeting states in which exploration was just starting and where it was still possible to set favorable conditions for future royalties and purchase from national companies.

What China expects from its investments in African countries is the enhancement of its energy security through long-term agreements. That is why Chinese companies pay great attention to economic forecasts and reserves projections, even holding them in higher consideration than political factors. For instance, Chinese investors seem to have decided to freeze their plans to build the South-Sudan pipeline because their studies show that oil supplies would not last long enough to repay the cost of the pipe's construction.

Beijing has adopted a multi-sector approach, embedding oil supply in government-to-government agreements and providing the host countries with infrastructure and investments, therefore enhancing bilateral trade and creating a sustainable level of interdependence.

The loans-for-oil system has become a model for other emerging powers (i.e. South Korea) and their policy of non-interference in domestic affairs has favored Chinese companies and diplomacy in accessing off-limits countries for European investors (like Sudan, Guinea Bissau, Eritrea). China's interests in light oil – easier to refine into gasoline – also directed Chinese foreign investments towards Gulf of Guinea and Southern Africa coast.[1]

Between 2001 and 2011, China's oil imports from Africa increased by an annual growth rate of 34%, while Africa's share of China's oil imports peaked to 25% in 2007. Since 2007, about one fourth of China's total crude oil imports have originated in sub-Saharan Africa, and more than two-thirds of Africa's exports to China consist of crude oil. Angola, Sudan, Congo, Libya, Algeria and Nigeria accounted for around 90% of China's oil imports from Africa. Whereas in 2007 only 10.4% of Africa's oil was shipped to China – with 11% exported to other Asian countries – by 2012 these figures had increased to 18.1% and 16.2% respectively, while European countries share remained unchanged.[2]



Source: BP statistical review, data's elaboration

The case of Angola provides one of the main success stories of China's penetration, based on energy and infrastructure investments. Starting in 2003, in less than ten years, China became the main economic partner of Luanda, despite the long-lasting American presence, and thanks to loans-for-oil strategies and infrastructures-for-oil agreements.

In several cases China has clearly, albeit tacitly, backed controversial governments to secure supply and increase its comparative advantage, as shown by Beijing's support to Omar Al Bashir in the Darfur crisis, or the cooperation offered to Teodoro Obiang Nguema Mbasogo's authoritarian government in Equatorial Guinea. At the same time Beijing's extraordinary performance in Africa is also due to its companies' access

1 H. Lee, D. Shalmon, *Searching for oil: China's strategy in Africa*, in "China into Africa", WFP, Brookings institution press, 2008

2 KPGM, Ibid., p. 5

to cheap assets and the great support that the Chinese government offers to investors, two elements that help China deal successfully with the three African 'G's: Geography, Geology and Governance.[3]

The case of East Africa exemplifies a new trend of a *rapprochement* between European and American companies and Chinese NOCs.[4] In Uganda, Tanzania, Ethiopia and Kenya Chinese state and non-state companies are involved in both upstream and downstream activities, but they are often offset by the competition of Euro-American, Middle Eastern and other Asian companies. On the other hand, infrastructural underdevelopment in the region is now forcing companies to create unusual joint ventures, such as Chinese-Euro-American cooperation. The creation of these joint ventures breaks China's isolation, and reduces its effort to differentiate its presence from that of other international actors. Being a financial stakeholder in infrastructure projects located in geo-politically unstable regions will have future implications regarding security and national sovereignty within African countries. The hypothetical case of Chinese and Western companies forced to jointly defend assets against a domestic African incursion challenges the common perception on the actors' differences and open competition.

China's presence is limited in gas supplier countries, with the exception of Tanzania. In Tanzania the Chinese National Petroleum Corporation (CNPC) is involved in the construction of a 500km pipeline, worth 1.2 billion dollars, and is designed to transport Tanzania's gas from Mtwara to Dar-es-Salam. Chinese companies have significant involvement in pipelines projects in Uganda, in the Ogaden Basin (Ethiopia) to Berbera (a port in autonomous region of Somaliland) and the Lappset project. The purpose of the project is to link South Sudan with the Kenyan coast and Lamu Island and the Cameroon-Chad pipeline. In Uganda, the construction of an oil refinery through which the government plans to meet the national demand, involves different actors, as the cost of the project requires all the partners to cooperate.

China faces growing criticisms against its investment policy: the African partners have become less and less tolerant towards the bad working conditions and low wages imposed upon African workers, most recently in the case of underage workers' protests in Ghana, but also towards the over-employment of Chinese manpower, to the detriment of the local labor force. The massive Chinese presence in the local market has been questioned as production methods have led to environmental pollution in Zambia and Gabon. Furthermore, the quality of construction standards in some projects has been questioned: some Chinese managers bribe local governments, thereby undermining good governance and putting other investors at a disadvantage. After years in which China prevailed as the only possible alternative, other emerging powers have started to invest in Africa, giving African governments the possibility to choose between competitors. This is evidenced by Brazil's strategy to differentiate its presence from China's by paying close attention to the employment of local workers and improved working conditions.

The current unrest in North Africa and the Middle East, together with the new wave of economic powers that adopted and improved the Chinese model, has led Beijing to rethink its African policy. According to China's 12th Five-Year Plan (2011-2015), released in March 2011, the Chinese Central Government will engage Chinese companies to operate overseas, and draws attention to the social responsibility and benefits to the local population of these overseas projects.

The Energy Factor in the Chinese Central Asia Projection

Central Asia – one of Eurasia's strongest areas for energy production and reserves – has become a strategic target of China's *Going Abroad* strategy. To Beijing's eyes, the relevance of Central Asian reserves is increased by significant geostrategic considerations. Although China has been effectively pursuing the diversification of its energy suppliers, it still suffers from an objective difficulty in accessing oil-producing countries. Due to the sheer size and the instability of the regions separating China from the main energy production areas, the county has developed an excessive dependence on maritime communication routes. Moreover, the costs related to the protection of the vital shipping lanes transiting through the Strait of

3 Reuters, *Africa Money-Uganda oil a sad story of the three Gs*, November 2012

4 R. Anthony, *China's role in the East African oil and gas sector: a new model of engagement?* Centre for Chinese Studies, Stellenbosch, 2013.

Hormuz and the Gulf of Aden turns this geographic disadvantage into a major strategic vulnerability – especially because of the Chinese naval inadequacy in offshore operations, and the consequent dependence on the maritime corridors' protection provided by the United States.[5] It is worth noting that the excessive dependence on sea routes also has a significant economic impact on LNG purchases. In this sector, China suffers from the regional competition of the two biggest world importers –Japan and South Korea – which results in extremely high import prices. Last but not least, the strategic relevance of China's cooperation with Central Asian countries derives from the benefit the latter may ensure in terms of regional development and stability, a critical issue related to its need to control Uighur separatist movements in the north-west Xinjiang Province.

China's penetration into the Central Asian energy market has been mainly driven by the region's availability of energy reserves, geographical proximity and economic benefits. The Sino-Kazakh 2003-2008 cooperation program, signed in Astana by Chinese President Hu Jintao and his Kazakh counterpart Nursultan Nazarbayev in June 2003 was a watershed for the Chinese presence in Central Asia's oil sector. The document committed the parties to strengthen their cooperation in the energy sector and promote and support the participation of Chinese companies in the exploitation of Kazakh natural resources. On this basis, between 2003 and 2005, CNPC became one of the leading players in the Kazakh oil market. CNPC's prominent position was further strengthened when it became the majority shareholder of AktobeMunaiGaz and even more so when it purchased PetroKazakhstan, a Canadian-led company owning the Turgai basin field's exploitation rights in central Kazakhstan.[6] Since then, China's penetration of the Kazakh oil sector has deepened through the CNPC's acquisition, in 2009, of 50% of the MangistauMunaiGaz's shares, holder of the exploitation rights of oil fields in Western Kazakhstan. It is worth noting that the acquisition of the company was part of a broader agreement – whereby the Export-Import Bank granted Kazakhstan a $10 billion loan, half of which was used by KazMunaiGaz, the national oil company, to acquire the remaining 50% of MangistauMunaiGaz.[7] Currently China's share in Kazakh oil production is 24%.[8]

After the first cooperation agreement signed in 2005, CNPC entered the Turkmen gas upstream sector in 2007 acquiring the 35-years exclusive rights to exploit the Bagtyyarlyk field, on the border with Uzbekistan. Besides the magnitude of the resources contained in the area which are estimated at 1.3 trillion cubic meters, the agreement is particularly relevant because for the first and, upon writing, the only time a foreign company operating in Turkmenistan was granted exclusive rights to onshore deposits without being required to enter into a partnership with Türkmengaz, the national energy company. This exemplifies how important this bilateral cooperation is, and one that is replicable through the engagement of Chinese banking institutions. Indeed, in July 2009 and again in April 2011, the Development Bank of China granted Türkmengaz loans for a total value of $8.1 billion, aimed at the development of the South Yolatan massive gas field – in whose exploitation CNPC concomitantly gained participation. As in other similar cases, the loan would have been repaid through gas supply – 40 billion cubic meters per year, as agreed upon by CNPC and Türkmengaz, between 2008 and 2009.

Besides entering Central Asian oil & gas upstream sector, China was also proactive in infrastructure plans designed to ensure the eastward flow of regional resources. As far as oil is concerned, Beijing's main achievement was the construction of the Kazakhstan-China pipeline, a 2,000 kilometers infrastructure running from Kenkiyak, a Kazakh network hub in the west of the country, to Xinjiang. Commissioned in two phases between 2006 and 2009, the pipeline is linked to the Caspian Sea shore terminal of Atyrau and was built – with Chinese funds – by a joint venture set up by CNPC and KazMunaiGaz. Current capacity of the

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5 See Z. WENMU, China's energy security and policy choices, in «World Economics and Politics», n. 5, 2003.

6 It is worth noting that in autumn 2005, CNPC ceded to it a 33% stake in PetroKazakhstan to comply with the Kazakh government to ensure KazMunaiGaz, the national energy company, participation in the exploitation projects in the country.

7 The remaining $5 billion were granted to the Kazakhstan Development Bank.
Yang J. and Ruan V., China, *Kazakhstan Sign Loan-for-Oil Deal*, The Wall Street Journal, 18 April 2009.

8 Xinhua, 27 September 2013.

pipeline is 14 million tons per year, to be upgraded within a year to its nominal capacity of 20 million – 6.1% of total Chinese oil net-imports in 2012.
However, it was in the gas transportation sector that China's energy policy gained its major accomplishments, in political, diplomatic and economic terms. The reference goes to the Central Asia-China Gas Pipeline, a 1,800 kilometers infrastructure with a capacity of 40 bcm/y running from eastern Turkmenistan to Eastern China, whose two lines were realized in a record time between 2007 and 2010. The rapidity in the pipeline's building is all the more significant in view of the long-standing regional competition among major regional and systemic actors for access to and transportation of gas resources. Moreover, the lack of a shared border between Turkmenistan and China entailed the need to involve transit states in the pipeline project, namely Uzbekistan and Kazakhstan, making intergovernmental negotiations even more difficult. However, despite these complications, the deal was struck in 2006-2007. Therefore, what appeared to be the main obstacle to the Central Asia-China Gas Pipeline, i.e. its transnational nature, turned out to be one of its major strengths. To date, the pipeline can be regarded as the most relevant product of regional cooperation in an area where the political-economic relations between major actors are usually strained. Furthermore, the transit through Kazakhstan and Uzbekistan will allow their involvement as suppliers, since the Beyneu-Shymkent pipeline, designed to connect the Kazakh Caspian field with the Central Asia-China Gas Pipeline, is going to be fully operational soon, while the opening ceremony for the third line was held in Uzbekistan in March 2012 and brings the total capacity of the pipeline to 55 bcm/y.

The apex of the Chinese penetration in Central Asia energy sector was achieved during the regional tour of the President Xi Jinping in September 2013, when extremely important deals were signed. Among the 22 agreements signed in Kazakhstan – worth on the whole about $30 billion – the most significant one in the energy field was the CNPC's acquisition of a 8.33% of the Kashagan Caspian giant field – home to 3% of the world's recoverable oil reserves – for about $5 billion. Moreover, CNPC also agreed to cover half of Kazakhstan's financing (up to $3 billion) of the field development’s second phase.[9] In Turkmenistan, Xi Jinping and his counterpart Gurbanguly Berdymukhamedov agreed to raise bilateral relations to the level of a strategic partnership. Energy and loans were once again crucial to the mutual improvement of the countries’ relationship, since they agreed to raise the volume of gas exported by Turkmenistan to 65 bcm/y by 2020, and to commit the China Development Bank to financing the second phase of development of the giant Galkynysh field through an undisclosed loan.[10]

Policy Implications and Recommendations

- European institutions have set out to conceive a new vision of energy security protection, focused at the same time on its external and political dimension. In such a view, the engagement of external energy partners became both a primary tool and a key goal of EU policies, aiming at ensuring the adequate supply of resources at reasonable prices, as well as gradually moving from cooperation to integration, through the promotion of a common regulatory space and, broadly speaking, through the extension of the EU’s norms, rules and institutions beyond its borders. As a matter of fact, China’s energy policies resulted in strong competition with the EU on both the aforementioned levels. Most of all, Beijing policies resulted in a growing competition for access to and the transport of energy resources.

- The EU’s response to China’s African strategy came late and proved hesitant. For a long time, EU countries have taken their economic presence in Africa for granted, counting on their solid relations with their colonies and their mutual political tights. In addition to that, until the early 2000s, EU countries have focused on supplies coming from Northern Africa – especially Algeria and Libya – and the Middle East. EU policies on energy cooperation with Sub-Saharan Africa have since been based on isolated initiatives, poorly connected with one another.

9 Reuters, 7 September 2013.
10 CACI Analyst, Field Report, 16 October 2013

- The EU proposed a trilateral dialogue and a cooperation mechanism that would enable the EU, China and Africa to coordinate conflicts of norms and interests. Inaugurated in 2008, the EU-China-Africa partnership has not found its actual reason for being. The partnership's primary aim should be regulating and, where possible, coordinating operations within the infrastructure and development sectors in the African continent. As in other domains though, the partnership sees on the one side the European Union trying to affirm 'common principles', which looks more like an attempt to make Chinese politics fit Western standards, and on the other side China rejecting the 'leading role' played by Western countries in international cooperation schemes. A greater engagement in enhancing dialogue and expanding the contents of this partnership is required.

- In Central Asia the EU lacks a clear focus and a coherent and comprehensive regional strategy. The inauguration of the so-called Southern Corridor, which will enable EU member states to import natural gas from the Middle Eastern and Caspian Sea areas, diversifying gas supply sources and channels, can represent a new course of the EU energy supply.

- The EU should focus on high levels of transparency, environmental preservation, attention to social compensations and development, better performances in relation to oil spill-over effects, technologic transfer, partner countries' support in improving refinery standards and infrastructures, and a careful exploitation of natural resources. A long-term view, based on mutual knowledge and respect, and an "open conception" of trade, in which oil is one of the best at stake, but is not the only one, is essential.

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