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RESETTING RELATIONSHIPS THE CASE FOR A NEW EU DIPLOMATIC STRATEGY ON FOSSIL FUEL PRODUCERS

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Europe's energy diplomacy has conventionally focused on securing access to fossil fuels and diversifying supply routes. The accelerating energy transition in Europe changes this picture. It presents new diplomatic challenges, such as access to technologies and markets. Meanwhile, dependence on imported coal, oil and gas is falling.

While a change in approach to energy diplomacy is needed, this does not mean that diplomatic relations with fossil fuel suppliers can be deprioritised. Fossil fuel producers are critical for Europe's geopolitical interests on climate, security, economic stability and equity and justice. New relationships are required.

A new EU diplomatic strategy on fossil fuel producers should focus on:

- **Just and orderly transitions:** Supporting producers to transition away from fossil dependence, including through transparency on future EU demand, transition planning and sharing Europe's experiences on just transition.
- **Shifting financial flows:** Avoiding further lock-in to stranded assets, through financial disclosures, re-directing investments by development banks and export credit agencies, and accelerating the phase-out of fossil fuel subsidies.
- **Multilateral approaches:** International convening and leadership coalitions to support a smooth and equitable transition away from fossil fuels.



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1. Introduction

Energy and diplomacy have long been closely intertwined. Europe is the world's largest importer of oil and gas. EU and member state energy diplomacy has conventionally prioritised engagement with fossil fuel producers and transit countries, with the aim of achieving adequate and diversified oil and gas supplies.

But the global energy landscape is changing fast, and this should trigger a reassessment of diplomatic priorities. Europe's climate targets and the European Green Deal seek to make Europe's energy system less dependent on fossil fuels. The rise of renewables and electrification means that access to technologies, markets, investment, skills and critical minerals are becoming the main determining factors of Europe's energy security, rather than access to fossil fuels alone.

While a change in approach to energy diplomacy is needed, this does not mean that diplomatic relations with fossil fuel suppliers can be deprioritised. Securing Europe's geopolitical interests (including on climate, security, economic stability and equity and justice) requires a new relationship with fossil fuel producers – not to secure their energy supplies, but to support their transition.

This paper outlines the case for a new European diplomatic strategy on fossil fuel producers, the changing nature of Europe's geopolitical interests regarding producer countries and the core components of what a new diplomatic strategy should include.

2. Europe's energy diplomacy

The EU's international energy diplomacy has traditionally prioritised relationships with supplier countries and focused on access to fossil fuels, diversification of supply routes and negotiation of supply deals.

The EU Energy Diplomacy Strategy – published in 2015 – lists as its first priority “diversification of sources, suppliers and routes”, focusing on gas. Diplomatic support was to be focused on “the Southern Gas Corridor, the Southern Caucasus and Central Asia; the strategic potential of the Eastern-Mediterranean region; the Euro-Mediterranean energy cooperation in the Southern Neighbourhood; the wider Middle East region; new energy sources in the Americas, Africa and Australia, including the potential of Liquefied Natural Gas (LNG)” – as well as Russia, Ukraine, Turkey and Iran.

In parallel to this fossil-focused energy diplomacy, however, the EU has been a strong international advocate on climate diplomacy and a key architect of the global climate regime. While the EU Energy Diplomacy Strategy insisted that “energy partnerships and dialogues should be coherent with [...] climate goals”, there was little to elaborate how this could be achieved. In practice the fossil focus of European energy diplomacy sat somewhat uneasily alongside Europe's climate diplomacy efforts, and signalled somewhat mixed messages to producer countries and other partners about the future of fossil fuels.

The EU's climate diplomacy efforts, meanwhile, focused primarily on territorial emissions, as this is the basis for emissions accounting in the United Nations climate regime. Targets and pledges have focused on reducing emissions at the point of fossil fuel combustion.

As a result, a climate perspective on fossil fuel production has been missing from both energy and climate diplomacy.

A changing landscape

The context for this diplomacy is now changing rapidly. The rise of low-cost renewables and other clean energy technologies are transforming global energy systems and reducing dependence on fossil fuels. As the IRENA Commission on the Geopolitics of Renewables concluded, this is reconfiguring global power relationships and empowering energy consumers over producers.¹ In place of access to fossil fuels, access to technologies, investments, markets and critical minerals become the key factors for energy security.

The economic shutdown associated with Covid-19 has exacerbated a global oversupply of fossil fuels, causing problems for producer countries and companies. In 2020, oil consumption dropped by 8%, coal by 7% and gas by 3%.² While prices started to recover, this volatility represents 'a dress rehearsal' for demand shocks in the coming energy transition.³

Europe's own energy needs are also changing rapidly. Previous energy diplomacy strategies were built on the assumption that European gas demand would plateau until around 2030, and European gas imports would continue to rise due to falling domestic production. European Commission modelling from 2016, for example, foresaw a 4% reduction in EU natural gas demand by 2030 compared to 2015 in its reference scenario – but EU natural gas imports were expected to increase by 10% in the same time frame.⁴

With the EU's 2050 climate neutrality goal and new 2030 target for a 55% greenhouse gas reduction by 2030, however, the transition away from imported fossil gas will happen more swiftly, changing the calculus of European interests. European Commission modelling shows that with the new target EU gas demand should reduce by around 30% by 2030 (compared to 2015). Instead of rising, EU gas imports drop by 13-16%.⁵ This falling demand means that pushing for further investment in upstream production and in import infrastructure is increasingly unwarranted.

¹ IRENA (2019) **A New World: The Geopolitics of the Energy Transformation**

² IEA (2020) **World Energy Outlook**

³ Chatham House (2020) **Fostering Resilience in Emerging Oil Producers**

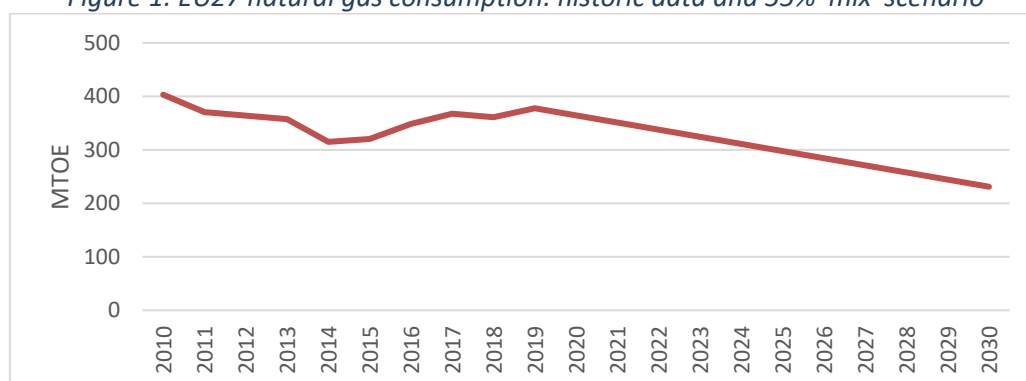
⁴ European Commission (2016) **EU Reference Scenario 2016: Energy, transport and GHG emissions Trends to 2050**

⁵ European Commission (2020) **Impact assessment: Stepping up Europe's 2030 climate ambition**



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Figure 1: EU27 natural gas consumption: historic data and 55% 'mix' scenario



Meanwhile, Europe's long-running energy diplomacy goal of diversifying gas supplies has largely been achieved. In its new energy infrastructure regulation proposal, the European Commission has decided to exclude gas infrastructure from EU support as previous investments and falling demand mean that energy security goals are already being met.⁶

European energy diplomacy is now being actively re-evaluated in the context of these trends. The European Commission's Green Deal communication promised a "stronger green deal diplomacy" that would "mobilise all diplomatic channels both bilateral and multilateral". European foreign affairs ministers will agree new conclusions on climate and energy diplomacy in January 2021, and a new EU strategy on international energy engagement is under consideration. Targeted diplomatic outreach to fossil fuel producers has also been proposed as part of the new EU strategies on methane and on hydrogen.⁷

These initiatives mean that this is an optimal moment for Europe to develop a proactive strategy on engaging with fossil fuel producers.

3. Re-evaluating Europe's geopolitical interests

This rapidly changing context requires a re-evaluation of Europe's geopolitical interests. While some of Europe's traditional priorities (e.g. securing access to new fossil fuel supplies) have waned in importance, relationships with fossil fuel producers continue to be of utmost importance for protecting Europe's geopolitical priorities.

Europe has four key interests that should drive its diplomatic relationships with fossil fuel producers: climate, security, economic stability, and equity and justice.

⁶ European Commission (2020) **Proposal for a regulation on guidelines for trans-European energy infrastructure and repealing Regulation (EU) No 347/2013**

⁷ European Commission (2020) **An EU strategy to reduce methane emissions**; European Commission (2020) **EU hydrogen strategy**.



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Climate

Climate safety is essential for European prosperity. Europe is exposed to physical climate change damages directly, and indirectly to climate-related economic risk, instability and insecurity. Both the European Green Deal and the EU's Long-term Climate Strategy recognise tackling climate change as core to protecting the well-being of Europeans.

The EU has emerged as a leading actor both in constructing the global climate regime and in decarbonising its own economy. Continuing to send mixed diplomatic messages towards fossil fuel producers and transit countries undermine EU diplomatic influence on climate.

Although the global climate regime is based on territorial emissions and commitments to reduce unabated fossil fuel consumption, there is now an increasing recognition of fossil fuel production itself as a critical climate challenge.

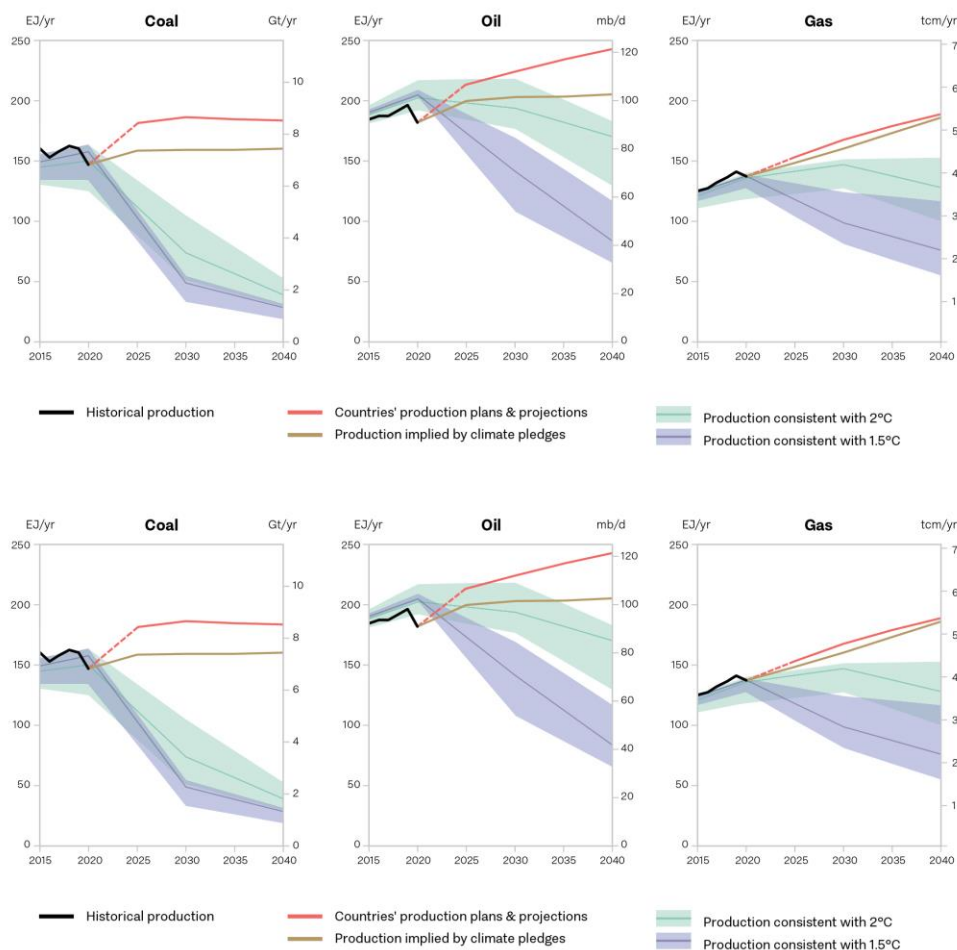
As mapped out in the UNEP Production Gap report, planned production of coal, oil and gas from supplier countries far outstrips the trajectories needed to meet the 1.5°C and 2°C climate goals.⁸

⁸ SEI, IISD, ODI, E3G, and UNEP. (2020). **The Production Gap Report: 2020 Special Report.**



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Figure 2: UNEP Production Gap report shows the gap between planned fossil production and climate-safe pathways



This challenge is political and diplomatic, not just economic. Without stronger transition plans of their own and alternative pathways to prosperity, fossil fuel producing countries may feel threatened by climate action and use their geopolitical power to derail progress on the energy transition. This phenomenon is already evident within UNFCCC negotiations where fossil producers have repeatedly attempted to delay or to water down climate agreements. As the threat to producer revenues deepens, the pushback from powerful fossil producing countries is likely to become even stronger and could range from political pressure to predatory pricing.

The political economy of ramping up climate ambition requires dealing with fossil producers: both to limit the extent of their opposition and to support them to become less dependent on fossil revenues.

A further climate imperative for engaging fossil fuel producers is the methane emissions from oil gas and coal production which – if left unchecked – threaten to blow apart the global carbon budget and make 1.5°C or even 2°C degrees unobtainable. Current



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methane emissions from oil and gas are estimated to be equivalent to 2.5 and 7 gigatonnes of CO₂ equivalent.⁹ These upstream emissions add at least a quarter to the emissions from burning oil and gas directly – but 75% of these emissions could be avoided at low or no cost.

The EU's new methane strategy recognises the need for diplomacy to agree common standards and to encourage transparent reporting of methane emissions. Through its international diplomacy with fossil fuel producers, the EU should be clear that oil and gas with high methane emission rates will be excluded from European markets in future.

Security

In the context of an increasingly rapid global energy transition, fossil fuel producing countries pose stability risks that affect European interests.

Fossil fuels have long been associated with conflict in multiple regions of the world. The 'resource curse' effect means that new oil and gas discoveries often inflame existing tensions as different factions seek to gain control of wealth and resources.

The global energy transition will not automatically result in a 'peace dividend', however. Many fossil fuel producers – including fragile and authoritarian states – are highly dependent on fossil revenue to maintain order. A disorderly transition (e.g. a sudden and unforeseen collapse in fossil demand and prices) increases risk of failed states and heightened conflict, including in the EU neighbourhood.

Supporting producers to reduce dependence on fossil revenues now can help to avoid damaging defaults and potentially lessen the risks of state failures and political unrest in the future.

⁹ IEA (2020) **Methane Emissions from Oil and Gas**

Economic stability

Europe also has a strong economic interest in an orderly transition by fossil fuel supplier countries.

The economic risk of a ‘carbon bubble’ of potentially stranded fossil fuel assets is now widely recognised by central banks and financial regulators as a key threat to the global economic system. Regulators are pushing for climate-related financial disclosures to manage these risks, and a growing number of investors are actively seeking to limit their exposure to fossil fuel assets.

But despite the focus by economic decision-makers, stranded asset risks have not yet featured strongly in energy diplomacy strategies. This is an unfortunate oversight: energy policy decisions – not just financial disclosures – are the critical tools for managing stranded asset risks. International energy diplomacy can play an important role in both identifying and defusing the carbon bubble risk.

Equity and justice

European countries and EU provide half of all international development aid, and development assistance is a key pillar of the EU’s external action.¹⁰ Dependence on fossil fuels by developing country producers poses serious challenges to international development, equity and justice aims as the global energy transition proceeds. For many developing country producers, oil and gas revenues are used to pay for spending on health, education and other social purposes. As prices fall, there are no longer sufficient revenues to maintain the social contract or meet development outcomes.

Some developing countries become more indebted in order to exploit their resources – in expectation of future revenues being available to pay down debt. But if fossil revenues do not materialise, this increases risk of debt distress and default.

This problem is expanding, as more developing countries (especially in Africa) start to rely on oil and gas production for the first time. A just transition requires building alternative pathways to prosperity for gas-dependent developing countries.

¹⁰ European Commission (2020) [European Development Policy | International Partnerships](#)



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Key relationships

USA

The US is now the world's largest producer of oil and gas, and – before Covid-19 – was expecting to be the largest source of new oil and gas supply to 2025. Much of this is intended for export: LNG export terminals with a capacity of 290mtpa are in planning and development in the US, representing 55% of global expansion.¹¹

In recent years, the US has engaged in aggressive international diplomacy to promote gas expansion, in order to create markets for US LNG and oil and gas services companies. Rollbacks of methane regulation has led to high levels of methane emissions from US oil and gas extraction.

The new US administration offers important new prospects for engagement, on climate policy in general and on fossil production in particular. However, the approach of the new administration to LNG diplomacy is not yet clear; this should be an early focus of US-EU dialogue.

Russia

Russia is the world's largest gas exporter, representing over a quarter of global gas trade.¹² Europe sources the majority of its gas imports from Russia, as well as imports of oil and coal. This dependence is a geopolitical risk to Europe, and EU energy security policies in recent years have focused on diversifying gas supplies.

The dependence, is, however, mutual: over 75% of Russia's current gas exports go to Europe. The Russian economy is heavily dependent on fossil fuel revenues. Europe's rapid reduction in fossil fuel demand implies major changes for the Russian economy and state revenues – and this will re-shape EU-Russia relations. The EU is the biggest source of foreign direct investment in Russia.¹³ This shows the potential for European investments to help diversify the Russian economy, but also underscores the economic risks to Europe of a disorderly transition in Russia.

Middle East and North Africa

A number of countries in the Middle East and North Africa are highly dependent on fossil fuel production, including Algeria, Libya, Saudi Arabia and Qatar. This dependence is deepening: planned gas investments have increased by 29% over the last year in the MENA region as a whole.¹⁴ Remarkably, 92% of this investment is from government sources, underlining just how large of a role government actors play in shaping oil and gas markets and taking on risks.

¹¹ Global Energy Monitor (2020) **Gas Bubble 2020**.

¹² BP (2020) **BP Statistical Review of World Energy 2020**.

¹³ Domínguez-Jiménez, M. and N. Poitiers (2020) '**FDI another day: Russian reliance on European investment**', Policy Contribution 03/2020, Bruegel

¹⁴ Apicorp (2020) **MENA Gas & Petrochemicals Investment Outlook 2020-2024**



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The region also has extremely favourable renewable energy potential, and some countries are beginning to explore green hydrogen production. Engagement with governments in the MENA region is needed to manage expectations of fossil fuel demand and to support clean investment.

Sub-Saharan Africa

A growing number of Sub-Saharan African countries are using fossil fuel production to fund their development. Nigeria, Angola and Equatorial Guinea are established oil and gas producers, while new production is under development in Mozambique and Tanzania. Exploration for offshore oil and gas is underway in South Africa, Namibia, Senegal and Mauritania, amongst others.

Government revenues from oil and gas projects in African countries are often far lower than initially planned, and these revenues may fall further as the global energy system accelerates.¹⁵ African producers are particularly exposed to reduced fossil demand: the IEA estimates that a delayed recovery of oil and gas demand following the Covid-19 pandemic could see African producers lose ~20% of revenues (around \$200bn) to 2040.¹⁶

As part of its Africa strategy and bilateral engagement, the EU should seek to support development outcomes in Africa while reducing exposure to volatile fossil revenues.

China

China is not a major fossil fuel exporter. However fast-growing energy demand means that China looks set to replace Europe as the largest oil and gas importer within the next two decades. Expectations of Chinese demand is driving investment new oil and gas globally.

In light of climate neutrality commitments from both Europe and China, the EU should work with China to set expectations on the global peak and decline of fossil fuel demand, and develop strong standards for methane emissions from oil and gas production.

¹⁵ Mihalyi, D, and T Scurfield (2020) **How Did Africa's Prospective Petroleum Producers Fall Victim to the Presource Curse?** World Bank Policy Research Working Paper.

¹⁶ IEA (2020) **World Energy Outlook**



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4. Elements of a new strategy

A new EU diplomatic strategy targeting fossil fuel producers should include three core elements: measures to support a just and orderly transition away from fossil fuels; shifting financial flows away from lock-in to fossil fuel production; and the development of multilateral fora to address the challenges from fossil fuel production.

Just and orderly transitions

1) Transparency

A key starting point for EU engagement with fossil suppliers is transparency on future European and global fossil fuel demand in the context of the energy transition. Europe's fossil fuel suppliers are continuing to invest in new production in expectation of continued European and global demand. The EU and European countries should proactively share fossil demand projections for their new climate and energy targets, and develop analysis of the implications for global fossil fuel imports under accelerated clean technology development and stronger global climate policies. This will support producer countries to avoid deepening lock-in to stranded assets and can be the starting point for dialogues on shifting their economies.

2) Transition plans

Europe should support development of transition plans for fossil-dependent countries, including an orderly wind-down of fossil production, to manage the impacts of the energy transition on their economies. These plans can form the basis of new economic partnerships between Europe and producer countries, to facilitate new sources of clean investment.

3) Just transitions for workers and communities

Europe has recent experience (both positive and negative) of seeking a just transition for workers and communities dependent on high emitting industries. The EU has created a Just Transition Fund to support economic diversification and new opportunities for workers in carbon-heavy industries, while the Coal Regions in Transition initiative supports local dialogues and new economic strategies.

The EU and European countries should seek to support just transitions in fossil producing countries by sharing lessons from these experiences, and by providing financial and other support to producer countries seeking to transition.

4) Just transitions for developing country producers

Special attention and assistance is needed for developing country fossil producers to support these countries to diversify their economies and identify cleaner routes to prosperity. This support could take various forms, including “debt for climate swaps” to help low income producers reduce dependence on fossil revenues.¹⁷

¹⁷ OpenOil (2020) [Compensating Indebted Countries for Keeping Fossil Fuels in the Ground](#)

5) Methane

International diplomacy on methane reduction is an important near-term diplomatic priority. This should support an international system for methane monitoring and reporting – and make clear that oil and gas production with high methane emissions will be blocked from European markets.

Reorienting finance

6) Disclosure

To manage economic stability risks from stranded assets, the EU should encourage fossil fuel producers to conduct climate-related financial disclosures, including from state-owned oil and gas companies.

7) EU investment

Public and private financial flows from Europe continue to underpin fossil fuel expansion globally. The EU should work to phase out investment in fossil production overseas by development banks, export credit agencies and other finance vehicles. Of the nine major Multilateral Development Banks (MDBs), seven have European countries on their boards – giving scope for European countries to push for more climate-friendly lending policies.¹⁸

The EIB has already committed to end lending for fossil fuels, and the UK recently committed to stop funding overseas fossil fuel projects from its export credit agency and other forms of financial assistance.

8) Fossil subsidies

Subsidies for fossil fuel production remain common. Fossil subsidies blunt market signals and deepen stranded asset risks. The EU should push fossil producers to phase out production subsidies – as well as phasing out its own remaining fossil subsidies.

Multilateral approaches

9) International convening on supply side transitions

As the UN climate regime is focused on territorial emissions, there is currently no clear venue for international cooperation on supporting supply-side transitions. (While OPEC acts to control levels of oil production, it is aimed at preserving the role of fossil fuels rather than phasing them out).

But this agenda is beginning to attract more international attention. As part of incoming US Vice President Kamala Harris's own presidential bid, she proposed an international summit of suppliers and consumers to smooth the transition away from fossil fuels, including “renewed commitments to fossil fuel subsidy phaseout and the first-ever global negotiation of the cooperative managed decline of fossil fuel production.”¹⁹ The EU now has a unique opportunity to work with the incoming US administration to set this convening in motion.

¹⁸ Ray, R (2019) **Who Controls Multilateral Development Finance?** GEGI Working Paper 026

¹⁹ Barnes, A (2020) **Kamala Harris' Plan For International Climate Cooperation Could Smooth the Transition From Fossil Fuels**



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10) Leadership coalitions

Several EU countries (DK, ES, FR, IE, PT) have made commitments to phase out oil and gas production (fully or partially) as part of their climate strategies. This gives the opportunity to showcase how a just and orderly transition away from fossil fuel can be achieved and to position fossil production as an important topic for the international climate agenda. European countries should work to create a leadership coalition on phasing out oil and gas production, modelled on the Powering Past Coal Alliance.

11) Institutional reform

The EU can play a key role in reforming international institutions to support the global transition away from fossil fuels. This could include widening the mandate of the International Energy Agency to give it an explicit role in supporting an orderly transition of fossil production. The International Monetary Fund, World Bank and multilateral development banks can also be critical sources of support for fossil fuel producers to shift to cleaner and more resilient economies.

12) Global agreements

A more ambitious aim for European diplomacy would be to seek the development of a global agreement to facilitate a smooth transition away from fossil fuels. The concept of a 'fossil fuel non-proliferation treaty' has been developed as an equitable approach for phasing down fossil fuel use and aligning fossil production with a Paris Agreement-compatible trajectory.²⁰

While such an agreement would take time to develop, a multilateral rules-based approach could support a more orderly, predictable and equitable energy transition than would be possible from market signals alone.

Conclusions

Engagement with fossil fuel producers has been a mainstay of European energy diplomacy for decades, as countries seek to ensure adequate energy supplies and diversify sources. The accelerating clean energy transition is shifting European diplomatic interests, as dependence on fossil fuel imports declines.

Diplomatic relationships with fossil fuel producers should be reset, but not deprioritised. Europe has strong economic and geopolitical interests in ensuring an orderly transition amongst producing countries and should seek out renewed partnerships based on clean investment.

As Europe develops its Green Deal diplomacy – including a new EU strategy on international energy engagement – and prepares for COP26, Europe's relationships with fossil fuel suppliers should remain high on the agenda.

²⁰ Newell, P. & A. Simms (2020) **Towards a fossil fuel non-proliferation treaty**, *Climate Policy*, 20:8, 1043-1054.



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About E3G

E3G is an independent climate change think tank operating to accelerate the global transition to a low carbon economy. E3G builds cross-sectoral coalitions to achieve carefully defined outcomes, chosen for their capacity to leverage change. E3G works closely with like-minded partners in government, politics, business, civil society, science, the media, public interest foundations and elsewhere.

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