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Charging the BRICS to Power the World

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Given the lousy growth prospects of mature economies, it is no surprise that the world has been hooked on emerging markets acronyms. The one that has stuck over the years is ‘BRICs’. What has made the godfather of alphabetical allies far more interesting than any other investment label is that its members have decided to turn it into a self-fulfilling political prophecy, replete with high profile meetings, joint statements, and a letter-matching new member (South Africa, with a capital S). How far the recapitalized ‘BRICS’ bloc can go depends on a wide range of factors. Strategic rivalries, markedly different political systems, structural constraints, and an uncertain global outlook provide easy headlines, but beneath them resides a thornier problem: how to align hydrocarbon supply and demand in a restive geopolitical environment. As the balance between established and emerging markets shifts, a common energy formula will be the key to BRICS success - or indeed failure. Roughly translated, that means Russia and India allowing for a Chinese hydrocarbon lead, with Brazil and South Africa providing gradated BRICS buffers. No doubt a tall order, but one to seriously ponder.

Logical energy foundations

On the face of it, the BRICS provide for a perfect division of labour. Russia and Brazil are core oil and gas exporters, China and India are consummate consumers; South Africa can unlock marginal production from the Gulf of Guinea to the deep waters of Mozambique, adding extra energy umph to the BRICS bloc. Looking at the map, the logical tie-up seems obvious. Russia becomes the hydrocarbon supplier of choice for China, freeing up excess Caspian and Gulf supplies to India and the European Union. Brazil’s estimated 15bn barrels of pre-salt reserves seep into the rest of Asia, above and beyond lubricating the Western hemisphere. South Africa ensures that the ‘Crude Continent’ remains open for business. While on the demand side, a Delhi-Beijing accommodation would give non-OECD players a cohesive voice, acting as an Asian counterweight to the IEA. The potential for BRICS growth and influence is thus enormous. Russia and Brazil pump the crude. China and India write the receipts. South Africa sooths political and market jitters.

Sounds great, other than the fact that no common BRICS vision exists on the energy front. Despite Russia’s need to develop East Siberian reserves and for China to import vast amounts of hydrocarbons, Moscow and Beijing have found it impossible to strike a credible deal on gas volumes and price. Instead, Beijing has been busy opening up new supply routes in Central Asia, wielding Caspian influence and reducing Russian clout. Prolific Middle Eastern and Australasian supplies have helped Beijing to drive a hard Russian bargain. Moscow has responded by talking up LNG and GTL options for its Eastern fields, threatening to leapfrog Chinese markets. But few analysts are fooled; emboldened by its arbitrage aces, China will look to turn the contractual tables on Russia.

Brazil has played with a straighter energy bat, attracting considerable international—not least Chinese—investment into its vast pre-salt finds. But as the race for the Latin American crown heats up, expect strategic control of resources to tighten, particularly if Western consumers end up squeezing Brazil too hard on excess capacity directly into OPEC's arms. If anything, the biggest threat to Brazil's prospects as an energy buffer resides in the statist DNA of the original BRICs, a shared 'condition' that predated the growth story of this Goldman inspired construct. For Brasilia, reducing political risk and courting Western investment will be crucial to ensuring that BRICS cohesion isn't construed as a direct threat to global energy markets. South Africa has played its part so far; rather than providing a Chinese beachhead into Africa, it continues to underwrite the continent's openness to European and American interests, while China has shifted its upstream attention towards unconventional Canadian plays, all of which is nice, other than it serves to highlight the broader emerging market issue at hand: BRICS supply isn't being calibrated to aid BRICS demand, or cohesion.

That's arguably with good reason. On the demand side, India and China remain embroiled in a nasty upstream battle in which hawks have staked ascendency in the 'Chindia' game. Never mind that Indian import dependency is considerably worse than China's, that Delhi's bids to gain upstream acreage have been disappointing at the best of times, or that the mounting pressures on the current account and the rupee have dashed residual hopes that the Singh government would build a $289bn sovereign wealth fund to secure supplies. Far from cutting India some much needed energy slack, China has been tightening its grip on Caspian and Middle Eastern suppliers. Adding strategic insult to geographical injury, Beijing has been beefing up its maritime presence in the Indian Ocean; that's hardly good news for an alphabetical ally whose land-based pipelines would have to pass through politically vexed Afghan and Pakistani territory.

Bulk up or bow out

None of these spats would cause serious concern, other than with advanced economies on the brink of recession and political retrenchment setting in, energy is fast becoming the pivot of the BRICS geo-economic and geopolitical fortunes. For the past few years, the BRICS movement has amounted to little more than a vehicle to gain leverage in the G7-dominated corridors of global financial and political power. Despite bouts of Russian rhetoric, the plan was never to move or act as an alliance, but to piggyback each other as means to achieve tandem gains. That didn't entail working as a single unit per se, but at the same time, it ensured that no alphabetical ally was left in 'splendid' isolation either.

Such an approach was all good and well until the financial crisis cast a long and dark shadow over advanced economies' ability to absorb emerging market export growth. With the Eurozone in a state of perpetual disarray and the US economy in similarly bad shape, the real question for the BRICS is whether they are willing to step up a gear and redefine the structural equations that underpin global economic and political governance, or whether they are going to play out time and continue hedging against an increasingly dysfunctional and discredited G7 way of (un)doing business. For China's part, that means making the long mooted leap of faith towards priming domestic demand rather than propping up Western export markets of old. These markets, rather than Chinese development, had been the main motor keeping the BRICS on tick over. The question for the other BRICS to ponder is whether they are willing to help grease Beijing's wheels and make a clear break with the past, or to keep running on potentially 'toxic' Western fumes.

Until now, Russia's eastern export strategies have been a hedge against its structural dependence on European hydrocarbon demand. Brazil has exploited Chinese interest in its resource endowments to position itself as a global player rather than a regional pawn, much like South Africa revelled in the BRICS accolade which allowed it to preserve a high international profile, despite the fading veneer of the Rainbow nation. But given the odds that the G7 will fail to regain its international footing, the days of the BRICS acting merely as a hedge are numbered. Ten years after their invention, the BRICS have to decide whether to bulk up or bow out as a serious political entity. Realistically, bulking up means the BRICS backing China, and Beijing taking on the responsibility to lead the bloc towards collective gains. In turn, Beijing has to seriously reconsider using energy as an investment vehicle of choice to bolster BRICS cohesion. Given China still has to work out what to do with its $3.2 trillion of reserves, they could do far worse than to channel vast amounts of cash into BRICS markets with energy used as the underlying 'asset' class in mind.

True 'BRICS believers' will no doubt point out that even if Brazilian and Russian supplies will inexorably lean towards Asian demand under the iron law of fundamentals. That may be so, but whether the West will bear the transitional geopolitical costs and the BRICS can withstand the political aftershocks of China's economic adjustment will depend on the BRICS ability to reach an accommodation on energy much sooner rather than later. China will have to make sure that the BRICS energy designs look like a blueprint for global energy supply, rather than a high gloss prospectus of BRICS potential.

China key, but broader rethink needed

The geopolitical key to BRIC ascendency is therefore not to channel all its energy towards China: To balance internal cohesion and external acceptance, Russia would have to accept a 'special relationship' along Saudi-US lines with Beijing, albeit with economic rather than security guarantees; India would be allowed to do its own thing, much like France or Spain did under the NATO umbrella, all while Brazil and South Africa would have to step up their acts as internal BRICS counterweights to convince Western powers that there is no need to balance the BRICS ascendancy.

Although the choreography is by no means simple, step one to bolster BRICS cohesion would see Beijing give India much more room to sign its own concessions. Delhi would of course have to accept that it is playing second fiddle and put the Chindia game to rest. Any upstream concessions Indian firms secured without Chinese competition should be graciously welcomed, not exalted in the usual rapture of democratic triumphalism. Perhaps more importantly, India and China would have to come to a broader and more realistic understanding of supply route security to avoid a muscular US response to an Indian Ocean naval race.

Over in the Atlantic, Brazil would have to curb its reliance on continued Chinese investment in order to assuage big oil that tightening control over pre-salt concessions was problematic. China may have sunk $10bn into earlier Petrobras funding rounds, but to tie Brazil into BRICS designs, Brasilia still has to cosy up to tetchy IOCs, just as South Africa will have to punch above its regional weight to entrench market rules and sooth political concerns over BRICS aims and ambitions. To anchor the BRICS in the broader geopolitical context, Pretoria and Brasilia have to act as regional BRICS trading posts, not as Chinese garrisons.

To open up that kind of policy space, the real clincher for the BRICS is for Beijing to hardwire Russia into its supply mix. Swap agreements could be the key to resolving pricing disputes, given Chinese oil majors' desire for equity stakes and Russia's need to ramp up Siberian investment and production. Any deal would obviously have to be generous enough to deter Russia from abusing its leverage over its traditional European supply bases on the one hand, while reducing Sino-Russian tensions over Central Asian producers on the other. Status quo politics and stability must become the overriding BRICS interest in the Stans, not fighting each other for strategic control over natural resources. The sooner Russia and China get down to serious energy business, the quicker Central Asian pressures will abate. India could then pick up any excess hydrocarbon supplies without treading anyone's toes. Greater EU access to Central Asian supplies would also offer the US a good excuse to drop out of an unpopular Caspian race.

BRICS cartography

Redrawing the supply map and charging the BRICS juggernaut with enough energy to make its way through the G7 debris, rather than dissipating its burgeoning geopolitical clout in an opportunistic free-for-all, will not be easy. More than anyone, China must decide how far it thinks the BRICS narrative could, and indeed should, be carried. But if the BRICS are to morph beyond a G7 hedge on a Goldman Sachs spread-sheet, Delhi and Moscow will have to accept that it's China's responsibility to do the heavy lifting here, all while Brasilia and Pretoria must live up to their buffer roles to ease the world into a BRICS-sustained future. Given the creaks in the international system, a Russo-Indian endorsement of Chinese leadership might prove to be as necessary as the entrenchment of African and Latin American outposts proves to be fundamental. Either that, or China might just decide this is all too politically messy and go it alone. In either scenario, the energy question that exemplifies the BRICS overall economic potential will seal its political fate. Energy will either cement the BRICS or break them apart. The rest of the world will have to live with the consequences.

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