

Turbulent International Energy Situation and Japan's Energy Policy Challenges

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Japan now faces the turbulent international energy situation and is required to develop and implement energy policies responding to the situation. First, Japan must tackle global decarbonization and carbon neutrality initiatives and achieve its goal of cutting greenhouse gas emissions for 2030 in response to global climate policy trends. Japan must also enhance energy security fundamentally in response to simultaneous energy price spikes as a global challenge since the second half of last year and the Ukraine crisis that has accelerated the spikes and destabilized international energy markets.

As well as the international situation, Japan's unique domestic challenges have become a key factor leading Japan to enhance its energy policies. Symbolic among these challenges is the tight electricity supply-demand balance. How to tide over the tight balance this summer and in the coming winter has become a grave challenge. The stabilization of the electricity supply-demand balance is not only a short-term challenge but also a long-term one. As various important challenges loom internationally and domestically, Japan is now required to develop and implement a relevant energy strategy. After winning a landslide victory in the recent House of Councilors election, the ruling coalition is set to have three years of absence in major nationwide elections unless the House of Representatives is dissolved. The current government has been given an important opportunity to focus on key political and social challenges without being concerned about elections. First, the government must promote energy and climate change initiatives toward the planned Group of Seven summit in Hiroshima next May and prepare for and step up discussions on the next Strategic Energy Plan.

While Japan faces a mountain of challenges to tackle, responding to key present energy security challenges is more important than anything else. The fate of the Ukraine crisis is ultimately unpredictable. Although crude oil prices weakened below \$100 per barrel amid global economic insecurity this week, uncertainties exist about how Russian oil supply will be affected by Russian oil embargoes by the European Union and others, how price caps on Russian oil as proposed at the recent G7 summit will develop and how Russia will respond to the development. Another focus of attention is how U.S. President Joe Biden's visit to Saudi Arabia, which holds the key to stabilizing the oil market in response to contingent supply disruptions and price spikes, will influence Saudi oil policy. Indications are that the international oil market and crude oil prices will remain stormy. Crude oil prices could skyrocket or plunge from the current levels around \$100/bbl. Crude oil price spikes may lead to hikes in liquefied natural gas prices indexed to crude oil prices and in electricity prices, dealing a serious blow to the Japanese economy. Japan is required to secure stable oil supply from the Middle East and contribute to oil market stabilization through the release of oil reserves in cooperation with the International Energy Agency in an emergency situation, while enhancing cooperation with other G7 members and Western countries.

Under the Ukraine crisis, the natural gas and LNG market faces a tough supply and demand

situation where the impact of supply disruptions may become enormous. This natural gas and LNG market problem is likely to become severer for Japan. A substantial decline (a suspension at present) in Russian gas supply through the Nord Stream 1 pipeline to Europe since mid-June has led to a fear of gas shortages in Europe in the coming winter, prompting major European countries to shift to a crisis response mode. In a symbolic development, Germany plans to use coal-fired power generation even at the cost of an increase in CO₂ emissions, giving priority to stable energy supply. On the other hand, European countries may desperately try to secure alternative gas supply sources in the face of the decline in Russian supply, leading the supply-demand balance in the international LNG market to tighten further. Given limited LNG inventories as well as the absence of surplus LNG supply capacity (like the surplus oil production capacity of Saudi Arabia), European countries and Asian LNG importers such as Japan may wage a zero-sum game race to secure LNG supply. Under the pressure of the potential race, European natural gas and Asian LNG spot prices have been rising rapidly since early July.

In such situation, Russia has exerted pressure on Japan over the Sakhalin 2 oil and gas development project since late June. A Russian executive decree to set up a new business entity to take over the operation of the project has threatened Japanese companies' equity stakes in the project. Uncertainties and insecurity have also emerged about the future course of Japan's LNG imports from Russia that total some 6 million tons most of which is supplied from the project. The pressure coincided with the tightening of Japan's electricity supply-demand balance, becoming a grave challenge to its energy security. The balance is expected to become even tighter in the coming winter. Japan is thus required to secure sufficient electricity supply in terms of both installed power generation capacity in kilowatts and actual power output in kilowatt-hours. Fuel supply holds the key to actual output. Stable fuel supply to LNG-fired power plants that account for a major part of Japan's power generation will grow important toward the coming winter. Securing LNG for city gas services is also important. Japan may be able to use other electricity sources for making up for LNG shortages. However, it may have to secure alternative gas or LNG supply sources for city gas services. Japan's government and private sectors will have to be united to secure stable LNG supply.

In such situation, Japan must do everything that it can on its own, including the implementation and enhancement of electricity and gas savings. Regarding stable electricity supply, it is important to prepare and develop arrangements for the stable operation of all available capacity including idled and private facilities for gas, oil and coal power generation. As indicated by Prime Minister Fumio Kishida, Japan will also be required to restart up to nine nuclear reactors while securing their safety. As a matter of course, Japan will have to make utmost efforts to secure additional LNG supply in the international market.

Japan should not only promote these short-term energy supply stabilization measures strongly but also make maximum efforts in the government and private sectors to realize the 2030 energy mix target set in the sixth Strategic Energy Plan. Although various challenges exist regarding goals for energy efficiency improvement, renewable energy, nuclear energy, hydrogen and other areas, Japan must accelerate efforts to implement policies with due consideration on the European Union's REPower EU Plan to phase out dependence on Russia. As for discussions on the formulation of the next Strategic Energy Plan, the government should work out policies to simultaneously pursue four policy objectives (Safety, environmental protection, energy security and economic efficiency), while giving top priority to energy security based on the international political and security environment and energy situation that have dramatically changed. While discussions on all policy fields are important, Japan should promote policy discussions on how to use nuclear energy for the four policy objectives in regard to nuclear energy policy that is politically and socially difficult.

On the international front, Japan should evolve cooperation with the United States and other G7 members and other countries with which Japan shares values in the difficult geopolitical environment and should promote collaboration in the energy and climate change fields. Japan should also pay attention to emerging and developing countries including those in Asia, which are set to lead future global development and growth, and cooperate with them in planning and implementing their energy and climate change policies contributing to their growth and development. In this respect, Japan should take policies to represent Asia at talks with G7 partners and other Western industrial countries. Japan should also prepare for formulating a new international energy strategy that will take into account China and Russia in the new international situation. Furthermore, Japan should promote fossil fuel decarbonization and other initiatives to structurally upgrade Middle Eastern economies for their stabilization and should lead talks between Middle Eastern oil-producing countries and oil-consuming economies in North America, Europe and Asia to help stabilize international energy markets. In a sense, Japan is required to develop an international energy strategy taking a panoramic perspective of the world map. Japan's domestic and external energy policies will enter crucial stages.

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