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Keynote Speech III

Changing Environments Surrounding the Energy Industry and Japan's Choice

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We have just had two of my colleagues deliver their speeches. I would like to express my thanks to Mr. Igor Kozin, who is a Director at the Russian Energy Ministry's Department of Pipeline Systems Development, and Mr. Khalid H. Al-Dabbagh, General Manager of Saudi Petroleum, Ltd. The two speakers presented their views on their respective countries' positions on a growing Asia and what energy policy choices are available at present and for the future in their countries. Their speeches have deepened our confidence that we can somehow maintain the stability of energy supply in Asia. I really wish to thank them for their speeches. I would like to renew my appreciation to them for presenting their views.

I would like to take this opportunity to frankly express my personal views -- what has come to my mind while working at IEEJ. My speech will cover three points. First I would like to evaluate how deeply the movement of global politics affects the international energy situation, second how the government is trying to improve various systems of the domestic energy market in response to changes in the economic situation, lastly and how Japan should steer its energy policy to pursue its national interest and maintain the coherency of its policy while taking into account changes in energy-related surroundings both at home and abroad.

The global community is now holding its breath to see if there will be any new developments in the Middle Eastern situation, particularly in Iraq. What could unfold in that area will present very important questions that have a direct bearing on the survival of not only Japan, but also other countries in Northeastern Asia, such as South Korea and China. Particular attention is being paid to Japan and South Korea, each of which is supposed to play a shared role in ensuring peace and stability in the region under their respective security arrangements with the United States which call for military commitments. Meanwhile, as you know very well, the energy that Middle Eastern countries supply to Asian countries such as Japan, Taiwan and China is vital to ensure their survival.

It may be unnecessary for me to repeat here our understanding that the issue of energy, along with that of food, has a security element which is seen as indispensable for each country's survival. Two conflicting issues in Northeast Asia are just emerging on the security front.

Given such an energy environment, our attention is now on what kinds of policy choices should be made by Japan, South Korea and other developed countries which are enjoying democracy and market-based economies. I think these countries are facing pressure to make an important decision that may determine their national and regional interests.

What I will say from this point is really my own personal views. If a particular country owns weapons of mass destruction, if the ownership of such weapons poses an imminent threat to its neighboring countries and if the existence of such a threat is recognized in the global community, that community also has a responsibility to eliminate the threat under the authority of the United Nations. I think any country would likely accept an action if it is backed by an international cause, and Japan and its people would also raise no objection to assuming part of the responsibility. Even Saudi Arabia, Iran, Kuwait and other Middle Eastern countries supplying energy to Northeast Asia -- they would also have no reason to oppose a U.N. action supported by an international cause. But if action is taken based only upon the principle of force and there is no legitimate cause for the action in the international community, then such an action would only result in creating “a jungle without rule.” If that happens, hostile sentiment toward Americans from people in the Middle East will be pent up, and that sentiment will eventually look for a vent for explosion, leading the global community to face greater confusion in the future. This is a situation that I am very concerned about.

The Northeast Asian region is becoming increasingly more dependent on the Middle East for its energy supply. Given the situation, taking the time to maintain stable relations with oil-producing countries and make them grow further will constitute an extremely important element for peace and prosperity in our region.

National interests in their policy toward the Middle East, however, are not necessarily the same among the United States, Japan and other economies in Northeast Asia. Japan, for example, depends on the Middle East for more than 90% of its oil import. The United States still sees the Middle East as an important supplier of oil, but has reduced their rate of oil dependency on the region to 20% to 25%. Differences in such dependency rates from one country to another leads to differences in the national interests being pursued by each country.

Japan and the United States have formed a security alliance, but that fact does not necessarily mean that the two countries should always take the same approach and action toward the situation in the Middle East. Japan is an Asian country who is also a friend of the United States, and the two countries

share the role of ensuring the peace and security in Asia. Having such relations makes it even more necessary for Japan to tell America that there are Japanese national interests and there are Northeast Asian national interests. This is so-called “peer pressure” -- or pressure that only a friend can place.

If an unfortunate event -- war between the United States and Iraq -- starts, we would have no choice but to fully turn to the excess production capacity held by Saudi Arabia and other Middle Eastern countries as a way to minimize the likely negative impact on the global economy. Mr. Al-Dabbagh presented the same view on this. In the event of war, I sincerely hope that the Middle Eastern countries would boost oil production to the limit in a bid to stabilize the supply-demand balance in the global oil market.

With that in mind, I have kept a close eye on the position each country in the Middle East has taken in order to minimize the possible impact of a military conflict on the world economy. I would now say that Japan and other Northeastern Asian countries should share great sympathy towards the Middle Eastern countries for the positions they have taken so far.

According to one calculation made by a British scholar, the excess oil-producing capacity of Saudi Arabia and others in the Middle East combined could be expanded to 3.75 million barrels a day, although it would take days for them to achieve this level. If the ongoing labor strike in Venezuela remains unsettled for the time being and is prolonged, and if Iraq's oil output drops to zero as a result of the war, the Middle East would face the very big task of stabilizing the world oil supply-demand balance.

And if the spare capacity held by the Middle East turns out to be insufficient to meet global oil demand following the onset of war and, as a result, the oil supply to the Asian market runs short, is there anything Japan can do to deal with the situation? At present Japan has oil stockpiles equivalent to 170 days of consumption and South Korea has 90 days of stockpiles. If the oil supply fails to meet demand in the event of war, and social unrest is feared to occur in Southeast Asian countries as well as those in Northeast Asia, I think both Japan and South Korea should consider releasing part of their oil stockpiles to help stabilize the supply-demand ties in the entire Asian market and restore stability there.

The issue of energy has become so big now that it can not be dealt with by a single country. The issue is therefore something that all members in Asia should work together for in the region's interest. In that sense, I think Japan and South Korea, both as industrialized countries in Asia, should take the role of leading the task.

As Mr. Al-Dabbagh emphasized, Northeast Asia has the highest growth potential in the world, as it includes China. A friend of mine from Saudi Arabia once told me that Asia is “a natural market” for the Middle East. This remark suggests the Middle East, situated in the far western part of Asia, and Japan, in the far east of the region, should further deepen their interdependence. I think Japan and the Middle East should strive to foster a relationship in which the same destiny is shared, even if establishing such ties takes many years.

We are a so-called energy-consuming country. The most important energy policy of such a country lies in the need to ensure energy security by diversifying both energy alternatives and supply sources. In other words, we should someday stop allowing ourselves to rely on the Middle East for all of our energy supply. In that sense, the role Russia may be able to play in the future, which Mr. Kozin touched upon, is very significant. Fortunately, Russia's political situation has been steadily stabilizing. Their economic situation is also improving, allowing higher predictability. This means the environment surrounding the ties between Japan and Russia is moving in a better direction.

When Japanese Prime Minister Junichiro Koizumi visited Russia in early January, he promised Russian President Vladimir Putin that Tokyo will study the feasibility of a pipeline project Russia plans to build to transport oil produced in its eastern Siberian city of Angarsk to Nakhodka in the Russian Far East. According to recent news reports, Japan has also committed itself to seriously study the natural gas project in Sakhalin. My view is that Sakhalin will likely become an area that can act as an important energy supplier to Asia -- not only to Japan but also to South Korea, China and India. In that sense, Sakhalin is strategically important for us. That is my view.

This may be something I have often said, but I will repeat it here again that there are three Ps that we should have in mind in formulating an energy policy. The first P is “proximity,” which is the idea of trying to get natural resources from the nearest location possible. The second P is “profitability,” which calls for both energy suppliers and consumers to strive to generate profit. Unless there is profit, no business would last. The third P is “political risk,” which I think should be minimized. I think that devising a policy based on these three Ps is necessary for any country to secure a stable energy supply. If the three Ps are taken into account, we should say the recent changes in Russia should be appreciated greatly. Such changes have convinced us that Russia will play an important role as a medium- and long-term supplier of energy to Northeast Asia.

In the past several years, Japanese government agencies, particularly the Ministry of Economy, Trade and Industry, have intensely discussed how to improve market order in the nation's electricity, gas and oil sectors.

The first step taken was scrapping the petroleum industry law, and the government has recently shown a new direction in market order in the power and gas industries. Since the end of World War II, Japan has adopted two principles in formulating policy for these two sectors. One is “regional monopoly,” an idea by which gas and power firms are allowed to operate exclusively in designated regions. The other is called “full cost principle,” which enables the firms to translate any operating costs into fees charged to end consumers. These two principles have supported Japan's postwar economic growth, and the concepts have played an extremely important role in furthering Japan's industrial development and improving the livelihood of the Japanese people.

Since the demise of the Cold War structure, a large number of new economies have emerged in the world, plunging Japanese industry into a new era of competition that presses for fundamental changes in its strategy to improve international competitiveness.

How to reduce energy-related costs for Japan's industry to regain international competitiveness is a pressing task that all Japanese people should tackle, and achieving that goal also would lead to ensuring our national interest in the energy field. From that point of view, we have agreed to infuse a market mechanism into the power, gas and oil industries as much as possible, and create a state of competition in these industries. That is the consensus we have recently reached, therefore maximizing cost reductions and surviving free competition will naturally become a strategic goal to be pursued by Japanese energy companies. In short, these companies will be charged with the task of lowering fuel costs as much as possible.

The global community has already established a market-oriented price system for oil products. The oil market in Japan is therefore integrated into the international market. The next challenge facing Japanese companies is how to link import prices of natural gas with international market prices.

Liquefied natural gas (LNG) was first supplied to Japan 30 years ago as an extremely valuable fuel source that can prevent industrial pollution and atmospheric contamination. In those days, however, natural gas had yet to be treated as a commodity. Therefore, during the initial days of trading the product, importers had to think about how to cover possible risks deriving from supply-side factors. Three decades later, natural gas is produced in various parts of the globe and the technology to generate the product has advanced significantly, so the international situation surrounding the LNG market has made a significant turn. Japanese companies, which import a major portion of world LNG production, are being forced to fundamentally review their traditional methods for contracts and devise ways to purchase energy -- natural gas -- at cheaper prices. I think their ability to respond to such needs is likely to become a major factor in determining whether they can survive domestic competition.

Under this context, I would have to say that the traditional method of concluding LNG contracts, in which purchases are made on a long-term basis and purchase prices are linked to crude oil prices and a “take-or-pay” system is adopted, should be reviewed. I think a key to achieving change is dependent on what Japanese companies may do in the international marketplace. This is common sense shared by the world community.

I heard recently that LNG being used to power an electric power plant in China's Guangdong Province will be supplied at prices 30% cheaper than before. Also, LNG being transported from Tanggu to a power plant in Fujian Province will be offered at cheaper rates. Given such price-cutting moves, it would likely be difficult for LNG produced in Sakhalin to enter the Japanese market -- unless its prices are cut further. The international situation affecting the LNG market has been undergoing rapid change, so this will test Japan's ability to respond to the change.
The next challenge for Japan is to take the initiative in the world natural gas market to bring about the happiness of people in Northeast Asia as well as Japan.

At this point I would like to point out the importance of coal as a fuel resource. This is a thing that we should not make light of. How to utilize coal -- natural resources that are rich in Asia -- and how to lower overall energy costs in Japan by using the resources are also a very important task faced by our country.

Coal is a valuable natural resource produced in abundance in the Asia-Pacific region, particularly in Australia, China and Indonesia. One option for our energy policy is to utilize the product more from the viewpoint of diversifying energy resources. I think it is necessary to foster the idea further.

Nuclear fuel has served as a prime mover in solidifying the fuel-supplying structure of electric power companies through the operation of atomic power plants. When the first oil crisis hit the world in 1973, oil accounted for 71% of Japan's total power demand. I have a vivid memory of the difficulty faced by oil distributors in securing oil when I worked at the petroleum division of the Ministry of International Trade and Industry.

In those days, officials at oil distributors underwent great hardships trying to prevent power outages by using allocated fuel oil. That memory is still with me. Since then, however, we were able to reduce the oil dependency rate to less than 10%. Mass media and economists have accused people engaged in energy policy of formulating an energy policy without a “specific strategy,” but I believe that the past 30 years of “sweating” efforts by the Japanese people and electric power companies to promote construction of nuclear power plants were a valuable achievement that can be termed as “strategic” and now has become a national asset. That achievement is the sort of precious asset which our generation

should carry into the following generations and foster more.

Policy on nuclear fuel has political aspects, including the management of plutonium, as it is deeply related to Japan's policy of nuclear nonproliferation. Therefore it is too risky to leave this matter to the market economy. It is therefore important for both the national government and the private sector to work together when we promote the construction of atomic power plants and pluthermal power-generating systems. We are now in an era where appropriate government intervention needs to be combined with efficient operation by private firms.

Energy markets can not simply be controlled under conveniently phrased ideas like market mechanisms. Our priority should first be placed on the safety of people and their security. If we are in an era and environment where introducing a market mechanism is deemed to be effective and appropriate, then we should start considering using such mechanism as a tool to meet the needs of the era.

Japan has almost finished creating a basic design for future power markets. This has also been completed in city gas markets. When we deal with these issues, harmonizing the two conflicting factors of market mechanism and national interest is the biggest challenge for Japan's domestic energy policy.

Finally, I would like to touch upon environmental issues such as the Kyoto Protocol in connection with energy policy. The environment is an issue that all humans should tackle in order to prevent global warming and possible natural disasters in the future. I think the Kyoto Protocol would provide an initial tool by which people around the globe can join hands with each other to fight global warming caused by the emission of carbon dioxide.

But the United States' failure to join the Kyoto Protocol has hurt the foundation on which the protocol is built, at least for the treaty's first commitment period, as the country is responsible for about one-fourth of world carbon dioxide emissions and about one-third of emissions in the industrialized countries. Japan and European countries have decided to strive for its ratification and implement measures envisaged in the protocol. Japan's decision to join the protocol may have been an inevitable choice, given the Japanese people's perception of environmental issues.

Japan and other countries are set to resume negotiations in 2005 over issues related to the protocol's second commitment period. We should do all we can to prevent talks from resulting in a repeated Washington failure to join the treaty. What conditions and terms would be acceptable for the United States to join the spirit of the protocol and implement the envisaged measures -- this is an issue the Japanese government should ponder seriously. An issue also likely to grip the government is to decide what conditions should be presented to developing countries like China and India for them to accept

observing the protocol, as these countries are projected to emit about half of world carbon dioxide in 2020. We should not repeat what happened during talks for the first commitment period when we deal with the second commitment period.

We should remind ourselves of the fact that tackling environmental issues is not like living in the world where campaign catchphrases such as "environmentally-friendly" can solve all kinds of problems. It's the world of power games where the national interests of one country confront those of another in a delicate manner and where a scene of carnage may result, with the future of its people and the national economy at stake.

Environment is an important issue, but when it comes to discussing that issue along with energy issues, I think all humans should join forces and look for ways to deal with the matter.

When discussing energy, we are facing issues on three fronts -- security, cost and the environment, but it is impossible to pursue a policy that meets demand on all three fronts at the same time. That would leave us with no choice but to change policy priority each time a certain problem emerges. My personal view is that, of the three fronts, security should be given the highest priority, as it has universal value. Cost is the second priority given the weakened international competitiveness of Japan's industry. We should start dealing with the third priority -- environment -- only when an international framework is established in a fair and equitable manner. That is my view, although it may conflict with that of the government.

Energy issues have kept changing and will continue to do so in response to changes in the surrounding international and domestic situations, but we should deal with them while monitoring their impact on national security and national interests under any circumstances.

Today and for tomorrow, experts from various countries are gathered here to discuss energy issues. Many of the experts are from Japan, and they are well known in their fields. I hope the participants will keep discussing this for the rest of the two-day symposium and enjoy it. Now it is time to conclude my speech. Thank you very much.

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