IEEJ e-NEWSLETTER

No. 58

(Based on Japanese No. 138)
Published: March 23, 2015

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Contents

Summary

1. US Watching: Union and Strikes Put Pressure on Gas Prices

The talks between the oil industry workers union and the companies are stalling, affecting 10 refineries nationwide. The union's demand for greater safety in oil plants would raise costs.

2. EU Watching: UK House of Commons Approves Hydraulic Fracturing for Shale Development

The ban on shale gas development was provisionally lifted in the UK. This move could affect the future of shale gas development in Europe, which so far has failed to take off.

3. China Watching: Prospects for Achieving the "Next-Generation Vehicle" Target of 500,000 Units

The output and sales of next-generation vehicles increased significantly in 2014. However, without greater investment in charging infrastructure, the cumulative production and sales target of 500,000 units is unlikely to be achieved.

4. ME Watching: The Threat of Spreading Extremism

As anger mounts over the IS killing of hostages, Jordan and the UAE have resumed air strikes, while Egypt conducted a retaliatory air strike on extremists in Libya. Saudi Arabia underwent a major government reshuffle which could indicate a family feud.

5. Russia Watching: Tensions Rise in Ukraine and the Stand-off with the West

With all eyes remaining on the situation in Ukraine, a four-country summit of Germany, France, Russia and Ukraine was held, resulting in a cease-fire agreement. However, the cease-fire is threatened by pro-Russian forces which remain active.

1. US Watching: Union and Strikes Put Pressure on Gas Prices

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Many must have noticed when Japan McDonald's began selling only the smallest bags of French fries on December 17, 2014. The incident reportedly was caused by a labor dispute by dock workers on the US West Coast, disrupting the delivery of potatoes. The stand-off between the International Longshore and Warehouse Union of stevedores and the Pacific Maritime Association, which manages 29 ports on the West Coast, caused a series of disruptions in stevedoring, until the parties reached a tentative agreement on February 20 following intervention by the US Labor Secretary to end the dispute.

The ratio of labor union participation in the US has declined from 20% in 1983 to 11% in 2013, largely due to the Right To Work law in effect in 24 states. The law, which prohibits forcing workers to unionize and guarantees employment without becoming a union member, was enacted in the 1940s in the southern states of Arizona, Arkansas and Florida, in 1976 in Louisiana as the oil industry prospered, in 1993 in Texas, another oil center, and in 2012 in the automobile state of Michigan and in Indiana known for its coal and steel industries. As the law spreads to the manufacturing north and political pressure against the unions mounts, the influence of unions on both companies and politics is likely to weaken. However, the labor dispute in the West Coast docks has forced ports to close, costing the US economy an estimated 2 billion dollars a day.

The oil industry is no stranger to labor disputes. In October 2014, one of the US's largest labor unions, United Steelworkers (USW), began a three-year negotiation with its 30,000 oil industry workers regarding their employment conditions, prior to the deadline for contract renewal on February l. Representing the oil companies in the negotiations was Shell. As plunging oil prices since the summer of 2014 have put downward pressure on wages, the USW demanded, in addition to a raise, improved safety measures at refineries, chemical plants, pipelines and shipping terminals. However, the negotiations failed to reach an agreement, and on February 2, USW members went on strike at eight refineries. The strike spread from February 10, and by February 22 was affecting in one way or another 13 refineries producing 3.3 million barrels/day (20% of US refining capacity).

Gasoline prices rose 12% in the three weeks since the beginning of February, and USW members work in as many as 65 refineries accounting for 64% of the nation's total refining capacity. In preparation for a possible expansion and extension of the strike into the high-demand period of gas from May, the training of substitute workers have begun. Furthermore, an explosion accident occurred on February 18 at an ExxonMobil refinery in California, which will cause California to lose 155,000 B/D of refining capacity for up to 6 months.

The accident not only directly affected the demand for petroleum products, but caused the USW to toughen its demands for safety measures. In recent years, the US has seen a string of accidents in oil facilities such as oil trains, pipelines and refineries, raising concerns that tougher governmental safety requirements may increase the cost of infrastructure investment and supply. The recent demand for higher safety for workers will further increase the cost of oil supply.

2. EU Watching: UK House of Commons Approves Hydraulic Fracturing for Shale Development

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On February 12, the UK House of Commons passed a bill that allows hydraulic fracturing within designated areas of the country for shale gas development. The UK had temporarily prohibited drilling by hydraulic fracturing since 2011 due to concerns by local residents and environmental groups about the environmental and earthquake risks associated with the technology. Following this decision to lift the ban by the House of Commons, shale gas development will resume in the UK, albeit in limited areas.

Initially, the bill offered unrestricted permission to developers to use hydraulic fracturing anywhere without approval by the landowner provided that the site is 300 meters underground or deeper. However, due to opposition by the Labour Party, the bill was later revised to prohibit horizontal drilling in restricted areas, such as national parks, which account for 40% of the UK’s land-based shale gas fields. Furthermore, regarding prospecting, developers will be required not only to obtain government permission but also take measures to prevent noise and traffic congestion for the local municipalities and residents.

The decision, which lifts the ban in permitted areas on shale gas development in the UK, will boost the UK’s independent shale gas mining companies. One of those, Cuadrilla, is set to drill eight exploratory wells in the Northwest this year. Cuadrilla’s CEO has commented that it has been confirmed that the UK has the world’s best shale rock layer, and so the future is bright for shale gas development in the country.

However, shale gas development in Europe as a whole is not going smoothly. Having a shale gas layer within its borders, Poland was initially enthusiastic about development, but exploratory drilling proved disappointing in terms of gas production and so major firms such as Chevron withdrew. There are also promising shale layers in east and west Ukraine, but there is almost no progress due to the armed conflict with the separatists. Meanwhile, in a move unrelated to the UK’s decision, the German government has recently introduced to the Bundestag a bill that would allow exploration for shale gas and coal bed methane by hydraulic fracturing. While the bill requires environmental concerns over hydraulic fracturing to be addressed before the technology can be used, it is notable that even Germany is considering easing the ban on the technology. The bill, if passed, would allow exploration of shale gas layers up to 3,000 meters underground.

Shale gas development in the EU would be a major means for achieving energy independence of the EU, which is seeking to improve its energy self-sufficiency due in part to the conflict between Russia and Ukraine. Although the IEA states that shale gas development in Europe has failed so far, the latest move by the UK could provide a last chance for Europe to repeat the US’s success in shale gas development. Progress should continue to be monitored.

3. China Watching: Prospects for Achieving the "Next-Generation Vehicle" Target of 500,000 Units

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According to the China Association of Automobile Manufacturers (CAA), in 2014, the output of next-generation vehicles[1] increased by 3.5 times from the previous year to 78,499 units, while unit sales increased by 3.2 times to 74,763 units. These are impressive results, even if they do not quite meet the 100,000 unit target which was expected at the beginning of the year. Cumulative outputs to date remain at 116,952 units, and cumulative unit sales at 113,355 units.

Looking back, 2014 saw the government ramp up efforts to encourage the use of next-generation vehicles (see the March and August issues of this Newsletter). In January, Prime Minister Li Keqiang and Vice Premier Ma Kai paid back-to-back visits to next-generation vehicle plants, and announced that the government will not change its target or relax its support measures. In February, the Ministry of Finance announced easing the rate of purchase subsidies cut from the initial plan of 10% to 5% from 2013 levels. In July, the State Council released the "Guiding Opinions on Accelerating the Expansion of Use of Next-Generation Vehicles", required the municipalities to build quick-charging infrastructure and the transmission companies to prepare transmission grids for the charging stations, and decided to exempt the 10% auto purchase tax until 2017. The National Development and Reform Commission announced a policy to keep the charging fee at commercial stations free, and to set the service rate at a government-controlled price. Further, in November, the Ministry of Finance established an incentive system for new charging stations based on the number of new next-generation vehicles introduced each year. For example, the 86 pilot cities will be offered 27 million yuan (1 yuan = 20 yen) if they introduced 5,000–7,000 units and 90 million yuan if the number reached 15,000 units in 2014.

Meanwhile, according to a study by the Ministry of Industry and Information Technology, as of October 2014, 23 pilot cities had not taken any measures to boost introduction. Even Beijing, which was the first to prepare an action plan to expand the use of next-generation vehicles (2014–17), and intends to establish the Beijing model as a national model and to become the world's number one in use, achieved only 40% of its introduction target of 20,000 units.

Why were fewer vehicles bought than expected? Demand from the public sector has undoubtedly increased, as the government requires the purchase of Next-Generation Vehicles for at least 30% of all new and replaced vehicles. Meanwhile, for general user, Next-Generation Vehicles become less expensive thanks to the tax exemption and governmental subsidies, but the most serious issue is the lack of charging infrastructure. Beijing currently has only 1,500 quick chargers, far less than the target of 10,000 chargers by 2017. The shortage could be due partly to the delay in launching construction incentives, as well as the poor environment for attracting private investment, as evidenced by the delay in standardizing chargers and not having a reference price for the charging service rate in most cities.

CAA's Executive Vice-Chairman Dong Yang estimated that production and sales will top 150,000–200,000 units for 2015, but commented that without additional measures, it will be difficult to achieve the cumulative production and sales target of 500,000 units. There is an urgent need to improve the investment environment for constructing charging infrastructure.

[1] In China, next-generation vehicles ("新能源汽車" in Chinese, and sometimes translated as "新エネ車 (New Energy Vehicles)" in Japanese) include electric vehicles (pure EV) that run only on electricity, plug-in hybrids (PHEV) that run mainly on electricity, and fuel cell vehicles (FCV). Hybrid vehicles (HVs) are categorized as energy conservation vehicles.

4. ME Watching: The Threat of Spreading Extremism

Koichiro Tanaka, Managing Director &
President of JIME Center

The Japanese hostage crisis involving Islamic State (IS) ended in the worst possible way, with the murder of the two hostages. This incident, combined with the gruesome video of the captured Jordanian pilot being burned alive, further enraged the Middle Eastern governments and the international community against IS. Despite its reputation as a skilled manipulator of the media, IS's recent outrageous propaganda has fueled resentment toward it even within the Islamic community. Yet, there was very little practical measure to prevent another terrorist attack from happening on foreign tourists in Tunis, Tunisia.

For instance, the UAE, which had been reluctant to be militarily engaged since the end of last year, was quick to join Jordan in air strikes on Syrian soil. Meanwhile, the UN is cutting channels for funding for the extremist group through a binding Security Council Resolution that prohibits member states from trading with IS and requiring them to freeze the group's assets in their country. Cooperation and compliance with the Resolution by neighboring Turkey are essential for tougher border controls, but even if implemented, it would take time to take effect.

Meanwhile, chaos is worsening in Libya, where a self-proclaimed subset of IS beheaded 21 Egyptian Copts, showing that extremism is spreading in the country more quickly than expected. Though Egypt quickly launched retaliatory air strikes, the "fight against terrorism" will make little progress in Libya or Syria unless the civil wars are brought to an end.

Saudi Arabia's King Salman, who announced that he would follow the late King Abdullah in diplomacy, is making changes domestically and has already started a major cabinet reshuffle. The sudden dismissal of two sons of the late king as governors of Riyadh and Mecca suggests a rift between the bloodlines within the royal family. Just as a transfer of power was under way in Saudi Arabia, in Yemen in the southern part of the Arabian Peninsula, anti-government Houthis, who had been putting military pressure on President Hadi of the provisional government, gained a decisive upper hand, forcing the President to resign (though later withdrawn when he escaped to Aden). Yemen is now split after the Houthis dissolved parliament, and the country is facing the serious threat of spreading extremism.

Regarding the nuclear talks with Iran, a foreign ministers' talk was held between Iran and the US in addition to the Munich Security Conference held in early February. However, there has been little real progress even though the deadline for reaching their shared goal of a political accord is only one month away. While many remain pessimistic about the negotiations, Israel Prime Minister Netanyahu has repeatedly warned against a "bad deal". His appeal to Congress in the US to block the agreement, together with his visit to the US, has badly affected his relationship with the Obama Administration.

In time for the visit to Japan by Qatar's Shaikh Tamim, a Japan-Qatar agreement was announced on collaboration in energy and economic areas, in particular the stable supply of LNG. As part of the agreement, a memorandum on academic exchanges was signed by the IEEJ and Qatar University.

5. Russia Watching: Tensions Rise in Ukraine and the Stand-off with the West

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Tension is rising between Russia and the West over the situation in Ukraine. The “Minsk Protocol” signed in September 2014 by the Ukrainian government and the pro-Russian forces was broken, and according to the UN the civil strife had claimed approximately 5,500 lives by early February 2015. Especially since this January, with pro-Russian forces launching fierce offensives in Donetsk and Lugansk in eastern Ukraine to extend their control, there has emerged growing consensus in the United States that they need to supply weapons to the Ukraine government forces unless Russia stops supporting the separatist armed insurgents.

As the international community feared an expansion of the war, on February 6, German Chancellor Merkel and French President Hollande held tripartite talks in Moscow with President Putin, followed by a US-Germany summit in Washington D.C. on February 9. Subsequently, on February 11-12, the heads of Germany, France and Russia with Ukraine President Poroshenko met for a four-state Summit in Minsk, the capital of Belarus. Concurrently, the Contact Group consisting of representatives of Russia, Ukraine, the pro-Russian forces, and the Organization for Security and Co-operation in Europe (OSCE) discussed the conditions for a cease-fire, and on the 12th, signed a comprehensive cease-fire agreement comprising 13 articles (including commencement of the cease-fire at 0 AM on February 15, Kiev time; creation of security zones in the border regions of the Ukraine government forces and the pro-Russian forces; and withdrawal of heavy weaponry), and the leaders of Germany, France, Russia and Ukraine adopted a joint statement supporting the agreement.

The Summit among the four leaders lasted an unusual 16 hours through the night. Chancellor Merkel commented that the agreement is a “faint hope”, but could not hide her disappointment at the unyielding attitude of President Putin. President Hollande also looked grim, and firmly stated that it is still too early to consider lifting the sanctions against Russia. Prime Minister Cameron, State Secretary Kerry, and European Council President Tusk unanimously welcomed the agreement, but remained suspicious of Russia which continues to back the separatists.

Confirming the fears of the international community, on February 16, the day after the start of the cease-fire, pro-Russian forces seized the eastern transportation hub of Debaltseve. President Putin appears to approve of the separatist offensives, and has made no real effort to solve the crisis.

Russia’s real GDP grew by 0.6% in 2014 (1.3% in 2013), while per capita disposable income dropped by 1%, falling for the first time in 15 years. In the Medium-term Oil Market Report 2015 released on February 10, the IEA estimates that Russia’s oil output will fall by 560,000 barrels/day in 2020 from 2014 levels due to the West’s sanctions and falling oil prices. Russia’s Ministry of Economic Development warns that the price of gas for the EU, which accounts for nearly 80% of all natural gas exports, could drop by as much as 35% in 2015. The stand-off with the West, if prolonged, would make it even harder to attract foreign investment to Russia and would cause further hardships for the domestic economy. Ironically, this could cause the Putin Administration to toughen its stance against the West to spur nationalism.

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Energy Indicators of Japan

IEEJ Homepage Top

Back Numbers of *IEEJ e-Newsletter*

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