

IEEJ e-NEWSLETTER

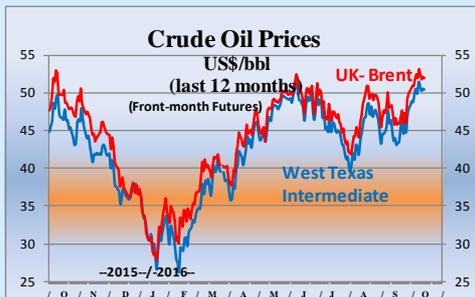
No. 96

(Based on Japanese No. 157)

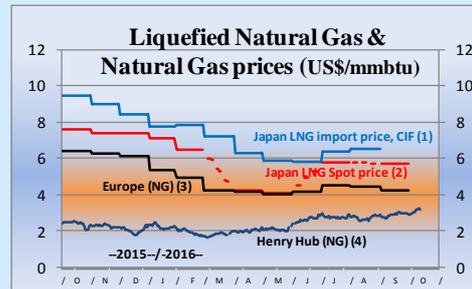
Published: October 21, 2016

The Institute of Energy Economics, Japan

(As of October 14, 2016)

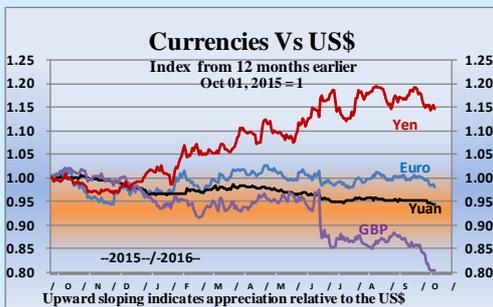


Source: DOE-EIA, Financial Times, NASDAQ

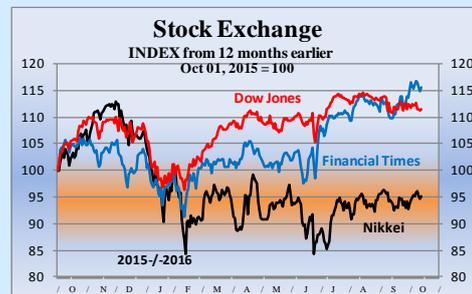


Sources:

- (1) Ministry of Finance "Japan Trade Statistics"
- (2) Ministry of Economy, Trade and Industry (contract month basis)
- (3) Estimated by World Bank and World Gas Intelligence
- (4) DOE-EIA, NYMEX (Front-month Futures)



Source: x-rates.com



Source: Financial Times

Contents

Summary

【World Monitoring】

1. US: Need for Consistency in the Ethanol/Mileage Policy
2. EU: Foreign Investment and Security Issues behind a UK Government Decision
3. China: G20 Hangzhou Summit and the Prevention of Global Warming
4. ME: Spotlight on Saudi Deputy Crown Prince's Visit to Japan
5. Russia: Japan-Russia Negotiation Advances amidst Russia's Economic Slump

Summary

【World Monitoring】

1. US: Need for Consistency in the Ethanol/Mileage Policy

The ethanol promotion and mileage improvement policy, intended for energy security and environmental measures, requires a compliance review. It will be interesting to see how this issue, which involves complex business interests, is addressed.

2. EU: Foreign Investment and Security Issues behind a UK Government Decision

The British government's decision on Hinkley Point C has once again highlighted the dichotomy between foreign investment in critical infrastructure and national security. The British government's new legal framework must be closely monitored.

3. China: G20 Hangzhou Summit and the Prevention of Global Warming

On September 4 and 5, the first G20 Summit hosted by China was held in Hangzhou. China presented to the international community a commitment to preventing global warming, including accelerating the enactment of the Paris Agreement.

4. ME: Spotlight on Saudi Deputy Crown Prince's Visit to Japan

The Saudi Deputy Crown Prince's visit to Japan greatly accelerated the discussions on bilateral cooperation. ISIS/ISIL is on the decline. The Saudi-Iran war of words and US-Russia discord over the civil war in Syria are intensifying.

5. Russia: Japan-Russia Negotiation Advances amidst Russia's Economic Slump

With no end in sight for Russia's economic ordeal, discussions continue on the "eight-point cooperation" plan proposed by Japan. The planned President Putin's visit to Japan at the end of this year is gathering international attention.

1. US: Need for Consistency in the Ethanol/Mileage Policy

Ayako Sugino, Senior Researcher
Coal & Gas Subunit
Fossil Fuels & Electric Power Industry Unit

The presidential election remains in close contest, with Hillary Clinton's lead shrinking in terms of voter support. While Hillary Clinton appeared to win the much-anticipated first TV presidential debate, the race remains too close to call.

There is a growing need to review the vehicle mileage policy. The Energy Independence and Security Act established in 2007 raised the target volume for ethanol car fuel to 36 billion gallons in 2022. Based on this Act, the Environmental Protection Agency (EPA) annually sets the amount of ethanol to be blended with gasoline sold in the country. Oil distributors are made responsible for selling biofuels. As gasoline consumption drops with the improvement of fuel mileage, the ethanol mix ratio needed to fulfill the sales quota rises. However, the mixing ratio is fixed at a maximum of 10% for safety reasons and fuel supply facilities. The EPA announced in 2010 that the ratio could be raised to 15% for 2001 model cars and later, but in most areas the maximum remains at 10% as fuel suppliers fear being charged with product liability for engine corrosion, and the delay in modifying infrastructure to the 15% ratio. In fact, the ratio of ethanol in retail gas had already reached 10% in 2010, dubbed the “blend wall”, so the oil industry is demanding Congress to reduce the sales target.

Further, since its inauguration the Obama Administration has been striving to strengthen fuel standards, promulgating in 2010 fuel standards for passenger cars and light trucks of 2017-2025 models. The standard for a 2025 model was set at 54.5 miles/gallon, significantly higher than the conventional 27.5 miles/gallon for passenger cars and 22.2 miles/gallon for small trucks. In setting these standards, the government worked closely with manufacturers to make the standards realistic, by gathering information such as the trends in technological development and cost, and the new vehicle sales strategies of automakers. Compliance with the standards was expected to be high, as the manufacturers themselves had submitted a statement of compliance with the final rules. However, in July 2016, the US Department of Transportation announced that the 54.5 miles/gallon goal was unlikely to be met as consumers were returning to large cars as gas prices fell. The Department further explained that 54.5 miles/gallon is not a mandatory “standard” but is a “mileage improvement assumption” based on the market environment as of 2010. Accordingly, Congress and the auto industry believe the fuel mileage standards need to be eased.

The policies for promoting ethanol and improving car fuel mileage, which were intended to boost both energy security and environmental measures, need to be made consistent as currently the more the fuel mileage improves, the more the “blend wall” worsens. However, this issue, which involves the interests of the auto, oil, and biofuel (agriculture, food, bio, and pharma) industries, environmental groups, and consumer groups, has been shelved for five years. Ahead of the presidential election, the Clinton campaign is carefully choosing not to mention this issue. Meanwhile, the Trump campaign initially supported biofuels, but in September, announced that mandatory ethanol mixing benefits mega oil companies while squeezing oil SMEs and thus must be reconsidered, with abolishment being an option. However, he was later forced to withdraw this policy after a factual error was pointed out. It will be interesting to see how this problem involving a complex web of interests can be resolved.

2. EU: Foreign Investment and Security Issues behind a UK Government Decision

Kei Shimogori, Researcher
Nuclear Energy Group, Strategy Research Unit

In September 2016, the British government announced approval of the Hinkley Point C nuclear new build project. The board of directors of EDF, the owner of the construction project, had already made the final investment decision at the end of July 2016. However, the May Cabinet, which took office at around the same time, had announced a comprehensive review of the project immediately after EDF's decision, a government decision that attracted much attention. The key point of the decision is that in exchange for granting approval, the government acquired the right to block the sale of EDF's shares, reflecting the national security concern of allowing a foreign capital firm to own domestic infrastructure of critical importance for energy security, such as a nuclear power plant.

As is evident from the large number of foreign capital energy firms in Britain, the British government has been encouraging foreign investment not only in energy but also in other infrastructure projects and assets such as airports and telecoms. The only existing law that stipulates the government's right to intervene for public interest is the Enterprise Act 2002. The Act authorizes the government to intervene in a merger or acquisition that it considers poses national or public security concerns. The process is executed jointly by the Cabinet minister who is authorized to intervene on the grounds of a particular public interest and to make the final decision on whether a merger or acquisition meets the public interest, and the Competition & Markets Authority (CMA). Although the British government has approved the Hinkley Point C project, it has simultaneously announced a revision of the project framework based on the Enterprise Act 2002 and the cross-cutting introduction of national security requirements to maintain the need for government approval for owning or controlling key infrastructure. Under the new legal system, the authority related to "national security" under the 2002 Enterprise Act will be expanded to also apply to key infrastructure.

Regarding foreign investment and national security, the US provides a model. Under the policy of welcoming foreign investment, the Committee on Foreign Investment in the United States (CFIUS) under the US Department of the Treasury reviews the acquisition of any domestic capital firm that might pose national security concerns. While it is left up to the parties to decide whether to apply for a review of an acquisition, the President, following the review by and with the advice of the CFIUS, has the authority to block the acquisition. The execution of Presidential authority must be based on reliable evidence that the acquisition would compromise national security, and the judgment that no other Federal law could provide sufficient protection. Although the President has not banned any acquisitions to date, in 2011, major Chinese telecoms firm Huawei voluntarily sold off the assets of 3Leaf, a US technology venture, upon the advice of the CFIUS.

There is no doubt that in making this decision, the British government is wary of the rise of China. Nevertheless, the key infrastructure projects currently planned will require foreign investment. Walking the thin line between an open market and national security is a challenge for all countries, not just Britain. As China's global presence in mega investment projects appears likely to grow, will the British government adopt a US-style review framework?

3. China: G20 Hangzhou Summit and the Prevention of Global Warming

Li Zhidong, Visiting Researcher
Professor at Graduate School, Nagaoka University of Technology

On September 4 and 5, the first G20 Summit hosted by China was held in Hangzhou. At the Summit, the first since the Paris Agreement, China presented to the international community a commitment to preventing global warming.

First, in the morning of September 3, the day before the Summit, the Standing Committee of the National People's Congress ratified the Paris Agreement, and in the late afternoon, President Xi Jinping and President Obama submitted their respective ratification documents to the UN Secretary General Ban Ki-Moon. The ratification by the US and China, which together account for approximately 38% of global emissions, marked a giant step toward a speedy enactment of the Agreement. Further, in the US-China Climate Change Cooperation Outcomes announced later that evening, both countries declared early participation in the regulatory efforts by the International Civil Aviation Organization, thus boosting the formation of a CO₂ reduction framework for international aviation, which is not addressed by the Paris Agreement. Both had been agreed as items of cooperation in the US-China Joint Presidential Statement on Climate Change released in this March, but announcing them immediately before the Summit was undoubtedly intended to deliver maximum effect.

Secondly, while the Summit theme was building an innovative, invigorated, interconnected, and inclusive global economy, global warming prevention was positioned as part of the theme. In the G20 Leaders' Communique Hangzhou Summit and the G20's first-ever Action Plan on the 2030 Agenda for Sustainable Development, the G20 countries reaffirmed their commitment to powerful and effective support and actions for sustainable development and climate actions, and each committed to complete domestic procedures for concluding the Agreement as soon as possible.

Regarding funding, which is a major issue for developing countries, the participants reconfirmed the importance of providing assistance for emissions reduction, including developed countries' funding for developing countries, and support through the Green Climate Fund. Further, based on the various reports on green funds submitted ahead of the Summit, the importance of channeling private capital to green investment was highlighted. Independently, China has already established the three-billion-dollar China South-South Climate Cooperation Fund, and issued 17.9 billion dollars of green bonds between January and August 2016, accounting for 45% of the world total.¹

"Reinventing Energy: China—energy consumption and supply innovation roadmap 2050", an international joint research program led by the Energy Research Institute of China, was unveiled. It caught people's attention by concluding that CO₂ emissions will peak around 2025, and will be reduced by 42% from 2010 levels by 2050 through energy conservation and expansion of non-fossil energies. At the Forum, Yukari Yamashita, Board Member of the IEEJ, presented Japan's experience in energy conservation, emphasizing the importance of energy conservation in building a low-carbon society and the significance of international cooperation by Japan, China and others. The presentation was received with much interest by the Chinese participants.²

¹ See, for instance, <http://dtfz.ccchina.gov.cn/Detail.aspx?newsId=63486&TId=170>.

² See, for instance, http://news.emca.cn/n/20160908102343_5.html.

4. ME: Spotlight on Saudi Deputy Crown Prince's Visit to Japan

Koichiro Tanaka, Managing Director &
President of JIME Center

On his way to the G20 Summit in Hangzhou, China, Deputy Crown Prince Muhammad (MbS) of Saudi Arabia visited Japan from August 31 to September 3 and held wide-ranging discussions with Prime Minister Abe on bilateral cooperation for realizing Vision 2030. In the various forums held during his stay, areas of cooperation such as energy, manufacturing, and services (culture & entertainment, sports, food, logistics, medicine & healthcare, etc.) were identified. The two countries agreed to launch the Japan-Saudi Joint Group for Vision 2030 and its first ministerial meeting convened in Riyadh in early October with the participation of the private sector.

After breaking diplomatic ties at the beginning of 2016, the Saudi-Iran war of words is escalating. In a speech to mourn the Iranian victims of the stampede at the Hajj last year, Iran's Supreme Leader Ali Khamenei questioned the House of Saud's ability to manage the holy sites. In response, Saudi Grand Mufti (supreme religious authority) Al ash-Sheikh fanned the flames by contemptuously referring to Iran's leadership as "the sons of the Magi (Zoroastrians)". Further, Saudi Foreign Minister Jubeir, who accompanied the Deputy Crown Prince to Japan, condemned Iran as destabilizing the Middle East from all directions. Meanwhile, in a contribution to the New York Times, Iran's Foreign Minister Zarif called on the international community to counter the threat of terrorism and radicalism by eradicating Wahhabism, which Saudi Arabia advocates, showing that the two countries are far from reconciliation. Despite this deep-rooted confrontation, an agreement was reached at an unofficial OPEC meeting at Algiers to cap total oil output. This agreement is widely considered as related to the Saudi economy's pummeling by low oil prices.

Islamic State (ISIS/ISIL) is weakening as the anti-government Free Syrian Army seized the northern Syrian town of Jarablus following the penetration of Turkish ground forces into Syrian territory. Subsequently, ISIS/ISIL fighters deserted the symbolic town of Dabiq with little resistance. In northern Iraq, Iraqi forces supported by US forces recaptured Shirqat to the south of Mosul, and subsequently the coalition launched the long anticipated operation to take back Mosul. To fight back, ISIS/ISIL is calling on its sympathizers to conduct "lone-wolf attacks" as individuals and small groups, and thus the threat of terrorism remains high. Meanwhile, the mistaken US bombing of Assad's forces in Deir Ezzor in northeastern Syria, and the retaliatory strike allegedly by Russian military aircraft on humanitarian vehicles to the west of Aleppo not only nullified the ceasefire mediated by the US and Russia, but has developed into mutual verbal attacks by the two countries at the UN Security Council.

As criticism and frustration mount in Iran over the delay in the lifting of economic sanctions, the US Treasury gave a partial green light to licensing the mass sale of Airbus and Boeing aircrafts. This gave President Rouhani the opportunity to finally show his people the fruit of the nuclear deal and momentum for reelection in the May presidential election. The political crisis in Iraq is worsening together with its financial crisis with the removal of Finance Minister Hoshyar Zebari by a vote of no confidence. Former Prime Minister Shimon Peres, who won the Nobel Peace Prize for contributing to Middle East peace, has died. A rocket attack against a UAE military vessel at the Bab el-Mandeb Strait by the Houthi rebel fighters and forces loyal to Yemen's former president Saleh, and similar attempts to target US naval vessels in the vicinity, prompted the US Navy to respond and destroy radar sites across the shorelines to the Strait.

5. Russia: Japan-Russia Negotiation Advances amidst Russia's Economic Slump

Shoichi Itoh, Manager, Senior Analyst
Global Energy Group 2, Strategy Research Unit

On September 2, in time for participating at the Eastern Economic Forum held by President Putin, Prime Minister Abe visited Vladivostok for a Japan-Russia Summit. At the Summit back in last May, Japan had proposed an eight-point economic cooperation plan: (1) Extending length of healthy living, (2) developing comfortable and clean cities that are easy to live in and support active lives, (3) fundamentally expanding exchanges and cooperation among small and medium-sized companies (4) energy, (5) promoting industrial diversification and enhancing productivity in Russia, (6) developing industries and export bases in the Far East, (7) cooperating on advanced technologies, and (8) fundamentally expanding people-to-people exchanges. The two leaders agreed to move toward realizing the plan. It was also announced that President Putin would visit Japan's Yamaguchi Prefecture on December 15.

Behind Russia's mounting interest in stronger economic ties with Japan lie three factors. First, the Russian economy has steadily slumped due to low oil prices and the West's economic sanctions. In the first half of 2016, the country's GDP growth rate fell 0.9% (year-on-year) while foreign exports plunged 18% from July last year and real disposable incomes dropped 8% from August. Given Russia's dire need to attract foreign investment, Japan is important as one of potential investors.

Second, there remain uncertainties over the relationship with China. As the West's sanctions continue, President Putin seeks to emphasize both inside and outside the country the ineffectiveness of containing Russia by strengthening its relationship with China. However, the volume of trade between Russia and China declined 28% year-on-year for 2015 and 7% year-on-year for January-July 2016, while China's investment in Russia has dropped 40% year-on-year (as of end-2015), thwarting Russia's expectations.

Third, President Putin believe that stronger economic ties with Japan, a G7 member, would weaken the unity of the West's sanctions against Russia.

On September 18, the State Duma Election of Russia was held, with the ruling party United Russia winning three-fourths of the seats, exceeding the two-thirds majority needed for constitutional amendment. The previous election in December 2011 saw a growing movement against Putin in the cities, but this time anti-government forces faced a harsh crackdown. Meanwhile, a prior national poll showed that only around 30% supported the ruling party, and fewer voters bothered to vote in an "election with a foregone conclusion", resulting in a 47% turnout compared with 60% in the previous election. With electoral fraud reported throughout Russia, the election has been dubbed "the most manipulated election" in post-Soviet Russia. President Putin declared victory for the ruling party immediately after the voting closed, and commented that "the people sought stability for society and politics". However, if the current economic slump continues, the government's actions in this election could fuel resentment toward the government later on.

Just one week after going into effect on the 12th, the Syrian ceasefire (September 10) between Russia and the US already collapsed easily, and the confrontation between US and Russia is intensifying again. How can Japan build a constructive relationship with Russia while being mindful of its relationship with the US and the G7 unity? President Putin's visit to Japan at the end of the year will certainly attract the world's attention.

Past IEEJ Events

Energy Indicators of Japan

IEEJ Homepage Top

Back Numbers of *IEEJ e-Newsletter*

Back Numbers of *IEEJ Newsletter* (Original Japanese Version - Members Only)

IEEJ e-Newsletter Editor: Yukari Yamashita, Director
IEEJ Newsletter Editor: Ken Koyama, Managing Director
Inui Bldg. Kachidoki, 13-1 Kachidoki 1-chome, Chuo-ku, Tokyo 104-0054
Tel: +81-3-5547-0211 Fax: +81-3-5547-0223
