Special Bulletin

A Japanese Perspective on the International Energy Landscape (42) May 13, 2011

China and Energy Security in Asia

Ken Koyama, PhD
Director
Strategy and Industry Research Unit
The Institute of Energy Economics, Japan

From May 1 through 7, I had an opportunity to take part in two international conferences in Bangkok and Washington for exchanges of views with many energy experts. While topics at these conferences ranged wide, common topics included energy security challenges in Asia and China's significance with regard to these challenges under the recent international political and economic environment.

Regarding the recent international political and economic environment, important factors include the destabilization of the Middle Eastern and North African (MENA) situation, crude oil price spikes, growing expectations on natural gas, the growing significance in Chinese political/economic/energy situation and the impact of the Great East Japan Earthquake. Based on these factors, I here would like to make four points about energy security challenges in Asia of which I grew conscious anew through the exchange of views at the international conferences.

First, Asia has been increasing its dependence on energy imports. Energy experts in the world agree that energy demand growth in Asia (particularly, in emerging countries) will drive global demand growth over a short, medium and long term. The energy demand growth in Asia may likely be steady, though depending on economic growth over a short term and on technological progress and the like over a medium to long term. Regarding gas (LNG) and oil, a can't-miss factor is that Japan's demand will be greater than expected earlier due to the Great East Japan Earthquake. Therefore, Asia's dependence on oil and gas imports is well expected to increase substantially. Inevitably, Asia will have to depend more on imports from the Middle East.

In this respect, the destabilization of the Middle Eastern and North African situation has become a new major issue for energy security in Asia. Due to the new issue, Asian countries will face a wide range of challenges including short-term problems like the enhancement of emergency response capacity to address market destabilization, long-term problems such as energy demand structure improvements and reforms, and diplomacy and international relations measures such as the promotion of relations with oil-producing Middle Eastern countries and the enhancement of energy cooperation within Asia. The energy import growth in Asia will also increase the significance of security of energy transportation from the Middle East and Africa, leading the sea lane issue to link closer to energy security. Combined with various territorial disputes in Asian waters, the sea lane problem has surfaced as a new focus of attention. The United States has also grown interested in the

problem from a strategic viewpoint.

Second, concerns have grown about the impact of crude oil price spikes, which can be linked close to the growing Asian dependence on energy imports. Factors behind the crude oil price spikes have been complicated, including geopolitical risks like the Middle Eastern and North African destabilization, as well as the growing influences of money factors in the oil futures market. As a result, the crude oil price spikes have become a significant economic challenge for Asian countries as major oil consumers and importers. In such Asian countries as China where concerns and cautions have grown about rising inflation, people have naturally grown more conscious of price hikes for energy resources, foods and other commodities. As factors behind the price hikes have been complicated, responses to the hikes may not be simple. As for gas subject to growing expectations as explained below, crude oil price spikes can directly cause LNG price hikes in Asia where LNG prices are linked to crude oil prices. In respect to this point as well, the crude oil price spikes can affect energy security in Asia.

Third, supply stability and energy security challenges are attracting attention with respect to gas that is expected to enter a “golden age” in Asia as well. As Asia features smaller share of gas in primary energy supply than Europe and the United States (the share stood at 11% in Asia against 27% in the United States and 26% in the European Union in 2009), Asia’s expansion of gas consumption means the diversification and dispersion of energy sources that contribute to energy security. In regard to stable gas supply, meanwhile, there are many problems including whether timely investment would be made to secure sufficient supply capacity in response to substantial demand growth in the future and how gas (LNG) prices would be competitive. We must also pay attention to the fact that how Japan’s substantial LNG demand growth under the impact of the Great East Japan Earthquake would affect the Asian gas (LNG) market over a short, medium and long term has become a great matter of concern to energy policy makers and energy industry people in Asia.

The fourth point is how China's presence is significant when energy security in Asia as well as the above three points is considered. This is because China's presence has remarkably grown greater as seen from a wide variety of viewpoints including the basic problem of the impact of China's growing energy demand and imports on the global energy supply-demand balance and non-supply/demand aspects such as China's strategies and actions in Asian and global energy markets. In discussions in the United States, key topics ranged from energy security to supply security for rare earths and other critical resources. Discussion participants indicated their great interests in China's policies and engagement regarding these problems. As for energy security, there are two matters of concern -- the impact of price spikes as described for the second point above and physical supply shortages. In the history of energy security, problems have mostly been linked to impacts of energy price spikes. Few physical supply shortages have been seen. In fact, however, fears of physical supply shortages could be taken as very serious and grave problems. China's rare earth supply restriction last year was taken as bringing about physical supply shortages. Since rare earths are indispensable for various high-technology products, they are of great importance in the military industry, technology and other strategic areas. Given these points, rare earth supply security and China's relevant presence have become matters of great concern. We may have to promote an

accurate analysis on China as a key factor affecting energy security in Asia, and dialogue and cooperation with China in pursuit of energy security as a common interest.

Contact: report@tky.ieej.or.jp

The back issues are available at the following URL.

http://eneken.ieej.or.jp/en/whatsnew/JPOIEL.html