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Summary

1. China Watching: Reform of the National Energy Administration

In June, the State Council restructured the National Energy Administration (NEA). This restructuring integrated the energy supply administration that had been scattered under the NEA, though it could not unify the compartmentalized energy administration.

2. ME Watching: Volatility Intensifying in the Middle East

The situation is changing quickly in the Middle East. In Iran, Hassan Rouhani was elected as the next president, while Turkey is struggling to control public protests, the Egyptian military staged a coup to oust President Morsi, and Qatar saw an unexpected transition of leadership.

3. Russia Watching: The Development of Sino-Russian Natural Gas Talks and Its Implications for Japan

China has negotiated with Russia over prospective natural gas trade. China, however, knows that Russia cannot help but hurry up the talks due to its own impending circumstances. Japan needs to explore the dynamics of the China-Russia relationship in building its strategy toward Russia.

4. US Watching: Enhancing the Environmental Assessment System

The US is moving toward enhancing its environmental assessment system (expanding the scope of environmental impact assessments), which could be applied to licensing and decisions concerning LNG exports and the construction of terminals.

5. EU Watching: Lithuania's LNG Import Plan – Reducing Dependence on Russia –

In a bid to ease its overdependence on Russia for energy, Lithuania is seeking to import LNG. Although this would lower gas prices by no more than 10%, it is a notable attempt by an energy consumer country.

1. China Watching: Reform of the National Energy Administration

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At the first meeting of the Twelfth National People's Congress in March, the "State Council's plan of institutional restructuring and function transformation" was adopted. Regarding the reforms of the energy administration, it was proposed to strengthen the authority of the National Energy Administration (NEA) by absorbing the State Electricity Regulatory Commission (SERC), a higher level organization, although it was decided not to establish a new Energy Ministry. Accordingly, the State Council finalized and announced the "regulations on the major responsibilities, structural organization and staffing of the NEA" in June.

With energy supply administration as its major role, the NEA has also been heavily involved in regulating and intervening in corporate affairs, including reviewing the long-term development plans of energy corporations and licensing direct transactions between producers and consumers of electricity. The "regulations" abolish some of these minor regulatory and intervention activities and transfer authority to the regions, while strengthening the higher functions of the NEA, including drawing up and implementing strategies, plans and policies for energy development, drafting proposals for energy system reform, maintaining order in the market, and ensuring a stable supply of energy, all at the national level. Accordingly, three new departments were established in the NEA, namely the Nuclear Power Department, Market Supervisory Department, and Electricity Safety Supervisory Department, increasing the total number of departments from nine to twelve. In addition, the roles of the departments were clarified by reassigning policy-making and total volume control to the Development Planning Department, and reorganizing the Policy, Law and Regulation Department as the Legal System and System Reform Department.

With this restructuring, the head-count of the NEA jumped from 112 to 240. Furthermore, six regional branches and twelve offices of the former SERC in charge of supervising electricity were attached to the NEA as affiliated agencies, with a total head-count of 500.

Despite the restructuring, the NEA will remain under jurisdiction of the National Development and Reform Commission (NDRC). Being responsible for running the overall national economy, the NDRC has immense power and is sometimes ridiculed as a "mini State Council". The "regulations" clearly require that proposals on key issues such as energy strategies, plans and pricing, and system reform drafted by the NEA must be reviewed and approved by the NDRC before being submitted to the State Council. Furthermore, the NEA will participate in setting the target for total volume control of energy consumption and supervise its implementation, but regarding energy conservation, which has the highest priority, it will only be in charge of the energy sector while the NDRC will be responsible for the final consumption sector.

Though the restructuring did not unify the compartmentalized energy administration, it did succeed in integrating the energy supply administration that had been scattered under the NEA. The former head of the SERC, Wu Xinxiong, who took office as head of the NEA and vice-chairman of the NDRC, summoned a meeting of NEA executives on June 17, and announced that he will make utmost efforts to fulfill the NEA's four duties of ensuring a stable supply of energy, optimizing its structure, improving its utilization efficiency, and driving system reform. The ability of the new NEA to fulfill its duties within the scope of its authority needs to be closely monitored.

2. ME Watching: Volatility Intensifying in the Middle East

Koichiro Tanaka, Managing Director &
Head of JIME Center

The string of events in June reminded the world that the waves of change in the Middle East are moving faster than imagined.

The presidential election in Iran ended in victory for center-right Hassan Rouhani against initial expectations. This surprise result is due to strong support among voters for the presidential candidate who pledged to overcome the stagnation caused by the hard-line conservative policy. Iran will now seek to improve its relations with the countries both inside and outside the Middle East. However, with little scope for a major change in its nuclear policy, we should not be overly optimistic about its negotiations with the US. In particular, the serious differences in stance towards Syria between Iran, Europe, the US, and other Middle Eastern countries do not bode well for improvements in Iran's foreign relations.

For the countries of the Middle East and North Africa which sought to shift to a democratic system through the Arab Spring, Turkey was held up as an ideal model of a balance between Islam and Western democracy. However, even in Turkey, a stable country, protests erupted in Istanbul as the public vented their frustration over the redevelopment of a park, which then spread throughout the country. The confusion worsened as the authorities began to force the protesters out of Taksim Square.

In Qatar, one of the wealthiest and most stable Gulf countries, an unexpected transition of leadership occurred with the abdication of emir Sheikh Hamad and the replacement of Prime Minister and Foreign Minister Sheikh Hamad bin Jassim. Amid various speculation including health problems of Sheikh Hamad, the most likely explanation for the transition is to minimize the potential confusion that could arise when power is transferred. As the country tries to find its way in the increasingly volatile Middle East through diplomatic strategies, the new emir will need a keen sense of balance.

Transition of power in Qatar was followed by another unexpected development: a coup d'état in Egypt. While millions demanded President Morsi to step down, the Muslim Brotherhood and its supporters continued to counter this movement by rallying behind the president, which eventually led the Army to issue an ultimatum to quell the dispute within 48 hours. General Sisi, the Defense Minister, acted swiftly to detain Morsi and to announce the installation of an interim government that would undertake a "democratic process" from scratch.

In Iraq where the security situation is worsening, terrorist attacks are once again increasing due to sectarian struggles, with the death toll reaching its worst level since 2008. In Syria, with the government forces regaining control of the strategic town of Qusayr with the support of the Lebanese Hezbollah, the Friends of Syria organized by Qatar agreed to provide emergency aid to the rebel forces. Signs of sectarian struggle are becoming more conspicuous.

3. Russia Watching: The Development of Sino-Russian Natural Gas Talks and Its Implications for Japan

Shoichi Itoh, Manager, Senior Analyst
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The developments of the natural gas negotiations between Russia and China are attracting attention worldwide. The IEA estimates that China's demand for natural gas will exceed 300 billion m³ by 2020 (2.8 times 2010 levels) and the country's export dependence will exceed 40%. As of 2012, Russia's LNG exports to China were only 0.5 billion m³ (natural gas-equivalent). However, if the two countries build gas pipelines connecting them in the future and exports grow, this would have a significant impact on the international gas market, especially on the supply-demand balance of Asian gas markets.

So far, one of the main reasons why gas pipelines have not been built between the two countries was the failure of gas price negotiations. At a meeting between Gazprom Chairman Miller and CNPC Chairman Zhou Jiping held in St. Petersburg on June 18, CNPC requested that the gas price be linked to the US Henry Hub price, but Gazprom rejected this, arguing that CNPC has already agreed to the petroleum-linked pricing system.

Russia is currently facing falling demand and a declining dependence on Russia in the European natural gas market, and so is being forced to turn to Asian markets. However, with new LNG supplies due to start arriving in Asian markets toward the end of this decade from competitors such as North America, Australia and East Africa, Russia needs to accelerate its negotiations with China and Japan.

On the other hand, China has been steadily increasing its imports of LNG and pipeline gas from Central Asia, and has sufficient supplies to last at least until the early 2020s. Thus, China will carefully watch Russia's reaction over time, and wait until Russia cedes enough ground to a level that is economically acceptable to China. During President Xi Jinping's visit to Moscow this March, Gazprom and CNPC agreed in principle to settle the negotiations on natural gas supplies from the Russian Far East (38 billion m³/year) by the end of 2013. However, many uncertainties still remain.

Currently, natural gas negotiations are becoming active also between Japan and Russia. On June 21, Rosneft signed a basic agreement with Marubeni and SODECO (Sakhalin Oil and Gas Development Co., Ltd.) on the sale and purchase of LNG in the Russian Far East starting from 2019. On June 22, the next day, Gazprom signed an MOU with Japan Far East Gas Co., Ltd. (a venture of five Japanese companies) for launching an LNG project in Vladivostok.

Japan needs to carefully explore the conflicts of interest between Gazprom and Rosneft and the dynamics of the China-Russia gas negotiations in formulating a strategy toward Russia.

4. US Watching: Enhancing the Environmental Assessment System

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In April this year, the Ministry of Economy, Trade and Industry and the Ministry of the Environment of Japan decided to accelerate the process for environmental assessments for building new coal-fired power plants. Likewise, environmental impact assessments on energy plants are gathering attention in the US and becoming a political issue.

In the states of Washington and Oregon on the west coast, under the influence of the shale gas revolution and with the shift in the electricity generation sector from coal to gas and the low demand for coal, there are plans to construct three ports for exporting coal. For the construction of a port and a railway connecting the coal fields to the port, an environmental impact assessment is required based on the National Environmental Policy Act. On June 18, the US Army Corps of Engineers in charge of the assessments of the ports announced its policy not to consider the impact of the coal exported from the ports on global GHG emissions. Mayors, Democrat members of Congress, and environmental organizations opposing the construction had asked that the GHG emissions resulting from inefficient burning of American coal in other countries, especially China and India, be considered.

The National Environmental Policy Act of 1970, which provides the basis for environmental impact assessments, requires federal departments to assess the direct and indirect impacts of any project that the departments license, but does not require any assessment outside the country, nor does it specifically state that GHG emissions must be considered. However, in February 2010, the White House's Council on Environmental Quality released draft guidelines instructing the departments to consider global climate change and GHG emissions in their assessments. This decision by the US Army Corps of Engineers came immediately before guidelines are due to be implemented shortly following a public comment period.

The foreseen tightening of environmental assessments (expansion of scope) is not unrelated to the LNG export plans of the US. Regarding the Freeport LNG project which was licensed in May for export to non-FTA countries, in a document announcing the conditional granting of the export license, the Department of Energy (DOE) stated that one of the benefits of the project was the positive effect on the global environment achieved by replacing petroleum and coal by American LNG in the export destination country. The Federal Energy Regulatory Commission is due to review the terminal construction plan of the Freeport LNG project, which will include an environmental impact assessment.

In a hearing at the House of Representatives on June 17, the deputy head of the DOE's Office of Fossil Energy testified about the future review policy of LNG export projects, and stated that the DOE is currently studying how far the scope of environmental impact assessments should be expanded. If the process of reviewing the LNG export and plant construction plans suggests that American LNG would increase GHG emissions in the export destination country, for example by replacing nuclear power, then the review may be prolonged.

5. EU Watching: Lithuania's LNG Import Plan – Reducing Dependence on Russia –

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Lithuania is a country on the Baltic Sea coast, bordering Latvia, Belarus, Poland and Russia. It separated from the former Soviet Union in 1990, and joined the EU in 2004. Lithuania now depends on Russia for 80% of its energy after its Chernobyl-type nuclear power plant was shut down at the end of 2009. To overcome this situation, the Lithuanian government is: (1) considering building the Visaginas nuclear power plant, (2) planning to build electricity grid networks connecting Lithuania with Sweden and with Poland, and (3) proceeding with the construction of an LNG import terminal.

Located at the far corner of the Baltic Sea, Lithuania is one of the farthest countries from the major LNG producers. Despite its transport disadvantages, Lithuania is promoting the import of LNG due to the constantly high price of imported gas from Russia. According to the quarterly report on the European gas market published by the European Commission, Lithuania's gas import price is 38.7 euros (€/MWh, which is 50 to 70% higher than the NBP price of the UK of 25.2€/MWh, which is among the lowest in Europe, and the average LNG import price of 22.3€/MWh. This is because Lithuania has just one pipeline for importing gas, which comes from Russia, and must buy all the gas that it needs from Gazprom, so the company has the power to set the price. Thus, to diversify its sources of energy and lower the purchase price, Lithuania has decided to build an LNG re-gasification terminal based on the floating storage and re-gasification unit (FSRU) technology. The reason for selecting FSRU over a land plant is because (1) FSRU requires 50% lower initial investment, (2) the construction lead time is two years shorter, and (3) it can be reused for LNG tankers if demand is uncertain.

Lithuania is planning to start purchasing LNG on the spot market and importing from 2015. Lithuania's demand for natural gas is 3 bcm/year, and the average import price of Russian gas was 0.3849€/m³ in 2012. Since the average NBP price (Europe's major LNG price index) of gas for 2012 plus the cost of sea transportation to Lithuania is 0.3273€/m³, Lithuania can reduce the gas cost by 3.8% by replacing 25% of the pipeline gas from Russia with LNG, and by 10% by replacing 60% of the pipeline gas.

As the NBP price is a market price, it could become higher than the price of Russian pipeline gas which is linked to petroleum product prices. Further, even by taking all these risks to import LNG, the gas price will be reduced by only 10% at most. Nevertheless, having an alternative source is crucial when negotiating with an energy exporter, and energy consumer countries must steadily do what they can.

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