

IEEJ e-NEWSLETTER

No. 52

(Based on Japanese No. 135)

Published: December 24, 2014

The Institute of Energy Economics, Japan

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

Contents

【Energy Market and Policy Trends】

1. New and Renewable Energy Subcommittee Should Engage in Fundamental Policy Discussions

【Global Watch】

2. ME Watching: Ad Hoc Response Continues in the Middle East

3. Russia Watching: Is There a Solution to the Stand-off with Europe

4. US Watching: Spotlight on the Congress Deliberations on Tax Reform

5. EU Watching: New European Commission Seeks to Strengthen Energy Security

Summary

1. New and Renewable Energy Subcommittee Should Engage in Fundamental Policy Discussions

Despite holding six meetings, the New and Renewable Energy Subcommittee has not started discussing concrete visions for the future. The Subcommittee should engage in fundamental and far-sighted discussions that are not confined to the current FIT system, but include the RPS and introduction of the bidding system.

2. ME Watching: Ad Hoc Response Continues in the Middle East

The issue of ISIS will be carried over into year 2015. The nuclear talks with Iran were extended again without any sort of framework agreement. The infighting of the GCC has stopped for the time being.

3. Russia Watching: Is There a Solution to the Stand-off with Europe?

The gap between Russia and Europe over Ukraine is deepening as a new pro-West coalition is launched in Ukraine while Russia continues to aid pro-Russian forces.

4. US Watching: Spotlight on the Congress Deliberations on Tax Reform

The highlights of US politics following the mid-term election are the discussions on comprehensive tax reforms and the federal and state tax reforms for securing road funds, as well as the response of the Republicans who now have a majority.

5. EU Watching: New European Commission Seeks to Strengthen Energy Security

The Energy Union increases the EU's power to negotiate with energy supplier countries, but is thought by some to hinder free competition within the EU. The Energy Union must be monitored closely.

1. New and Renewable Energy Subcommittee Should Engage in Fundamental Policy Discussions

Hisashi Hoshi, Board Member, Director
New and Renewable Energy & International Cooperation Unit

At the end of September, five electric utilities announced that they would refrain from responding to applications for grid connection due to the large volume of solar capacity that had been licensed. The Electricity System WG has been established to discuss the issue intensively and is now doing so. On what basis were applications suspended, and was the decision correct? The WG's mission is to establish a transparent and highly objective common understanding on the formula for calculating the amount of renewable energies that the grid can accommodate. This urgent issue of grid connection has suddenly arisen, but it had to be dealt with at some point. Taking this opportunity, we hope that the WG's output will make an important contribution to the future grid optimization measures and in designing the system for promoting renewable energies.

Meanwhile, the New and Renewable Energy Subcommittee, which is tasked with setting a vision for the introduction of renewable energies, has not yet begun specific discussions on revising the system despite holding six meetings since its launch in June. Since the issue of pending connections has occurred, much of the time has been spent on how to modify the existing purchase system. For example, the sixth meeting on November 5 mostly discussed reviewing the output limitation rules, how to determine the timing to apply the new purchase price, and dealing with licensed projects that have been taking up connection slots without starting construction, all of which are associated with the problem of pending connections.

However, the fundamental cause of the pending connections is a design problem peculiar to Japan, even though the problem is occurring within the FIT system, which makes it a unique case.

The direct cause of this situation was the last-minute surge in applications before the purchase price was cut, but this in itself is not rare. Germany has frequently experienced a last-minute surge of applications in the past. However, even the largest of such rushes, the one in December 2011, was a mere 3 GW. In Germany the purchase price is determined at the start of plant operation, and so applying at the last minute faces inherent limits. In comparison, in Japan it is possible to secure an advantageous purchase price just by submitting documents, without even having to ask the power companies for confirmation. The system unilaterally benefits the electricity producers, who can easily secure their rights, but can walk out at any time if things do not work. It is similar to ordering a car before a hike in the consumption tax so that the old tax rate will be applied no matter when you actually buy the car. This design problem lies behind the 27-GW surge in capacity applications for March alone that caused the system to hang up.

Although an urgent response is needed, focusing on peculiar cases such as this one is inappropriate as the main theme of the New and Renewable Energy Subcommittee, whose mission is to shape the vision for Japan's future renewable energies policy from a broader perspective.

The New and Renewable Energy Subcommittee is a forum for discussing the future direction of promoting renewable energies based on the Basic Energy Plan. At the first meeting, a great but difficult goal of "maximizing the introduction of renewable energies while minimizing the public burden (Commissioner Ueda of the Agency for Natural Resources and Energy)" was confirmed. What is the best way to achieve this? For the future, the Subcommittee should engage in fundamental and far-sighted discussions that are not confined to the current FIT system framework, but include possible rethinking of the RPS and introduction of the bidding system.

2. ME Watching: Ad Hoc Response Continues in the Middle East

Koichiro Tanaka, Managing Director &
President of JIME Center

As expected, the crisis in Iraq and Syria, caused mainly by ISIS, is threatening to continue into next year. Military operations in Iraq have produced some successes such as the battle over Baiji halfway between Baghdad and Mosul, but have not managed to change the course of the war. Further, ISIS influence may be spreading into Saudi Arabia, which fears that extremism could trigger sectarian clashes on its own soil. Reports of the death of ISIS leader Baghdadi have been largely dismissed. Meanwhile, the mass execution by ISIS of the leaders of Sunni tribes which are resisting ISIS's authoritarian rule in Anbar Province shows the magnitude of friction between ISIS and local Sunni tribes, as well as other minorities, and ISIS is likely to face fierce resistance going forward. However, the sudden resignation of Defense Secretary Hagel could have a significant impact on US involvement.

The nuclear talks with Iran did not reach a conclusion on the goal of achieving a comprehensive long-term agreement, despite repeated foreign minister-level multilateral and bilateral talks and top-level adjustments of opinions between the member countries in November. It is disappointing that the issue was not resolved after one year of negotiations, but fortunately a collapse of the negotiations was avoided as the framework for discussions for closing the gap between the parties was maintained, thus easing tensions and fostering trust between the parties. The negotiation teams shortly resumed their work on 17 December before adjourning for Christmas and New Year's holidays. Meanwhile, the restriction on enrichment activities based on the provisional agreement, as well as the easing of sanctions, will be maintained.

However, with the defeat of the incumbent Democratic Party in the US mid-term election, resulting in a Republican majority in both houses, there are now more barriers to lifting the sanctions, as Iran is demanding, even if the talks on the agreement make good progress. President Obama commented in a TV interview on the 23 November that President Rouhani should not miss to take this opportunity; however, the Iranian side also realizes that President Obama would make a political decision in haste to leave a legacy behind. In short, both the US and Iran are expecting the other party to make a concessional move, and so the negotiations are unlikely to make much progress.

The unusual infighting in GCC associated with Qatar's pro-Muslim Brotherhood stance that had threatened the convening of the GCC annual summit in December was settled, thanks to the mediation by the Amir of Kuwait. Nevertheless, the UAE, which remains critical of Qatar, has not forgotten to put pressure on Qatar by specifying 83 groups, including the Muslim Brotherhood, as terrorist organizations. It is uncertain whether Qatar will revise its policy as required, as the policy is associated with the substantial influence of Islamic preacher Yusuf al-Qaradawi, who is under the protection of the country.

3. Russia Watching: Is There a Solution to the Stand-off with Europe?

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

On November 16, President Putin skipped the luncheon and the rest of his schedule at the G20 Summit, and left Brisbane, Australia before the other participants. In Russia and all around the world, the media reported that Putin left early because the other heads of state shunned him. While German Chancellor Merkel and other European leaders warned Putin that his country faced more sanctions unless he stops assisting the pro-Russian militants who continue to fight in eastern Ukraine and try to stabilize the Ukraine situation, he remains completely intransigent.

In the election of the Supreme Council of Ukraine (the equivalent of the parliament, 450 members) on October 26, the ruling Petro Poroshenko Bloc led by President Poroshenko won with 132 seats, followed by the People's Front led by Prime Minister Yatsenyuk with 82 seats and the west-based Self Reliance Party with 33 seats. On November 21, five pro-West parties, namely the above three parties and the nationalism-inclined Radical Party and All-Ukrainian Union "Fatherland" led by Yulia Tymoshenko, a former prime minister, signed a policy agreement to launch a coalition of roughly 290 seats.

On November 2, parts of pro-Russian-ruled Donetsk and Lugansk in eastern Ukraine enforced elections to choose their own leaders and council members, ignoring calls by the Ukrainian government and the West to call it off. The Russian government effectively gave silent approval for those unconstitutional elections by pro-Russian forces, by releasing a vague statement expressing "respect for the popular will of the eastern Ukraine residents", without explicitly mentioning the word "approval". In eastern Ukraine, pro-Russian militants are again intensifying their attacks, and Russia continues to provide support including supplying weapons to the militants. In response, the West and the Ukrainian government are harshly condemning Russia, which they consider has no intention of respecting the peace plan (the Minsk Protocol) signed in September by representatives of Russia, Ukraine and the militants under the auspices of the Organization for Security and Co-operation in Europe (OSCE).

By preventing Ukraine from signing an association agreement with the EU in November 2013, Russia precipitated the Ukraine crisis, including the downfall of the then President Yanukovich in February 2014, that continues to this day. One year on, the new Ukrainian coalition is leaning further toward the West, and is determined to join the EU and NATO in the future. While most Western countries think it is still too early for Ukraine to join these organizations, the state of distrust and confrontation between Russia and the West is worsening.

4. US Watching: Spotlight on the Congress Deliberations on Tax Reform

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

With the result of the mid-term election on November 4, the GOP will have a majority in both houses in the 114th Congress that starts in January 2015. One of the major items on the agenda of the next Congress is tax reform, which was initially planned to be discussed in 2014. The corporate tax rate in the US is relatively high compared to international levels, but there are various tax preferences and tax breaks. This makes it difficult and troublesome to calculate taxes, incurring a high burden for both business and government. The goal of the comprehensive tax reform is to lower the corporate tax rate to enhance the US's competitiveness in the world economy, while simplifying the tax system by eliminating or reducing many of the loopholes, lowering the effective tax rate and the paperwork for tax payers. Tax reduction has always been one of the GOP's highest priorities, and the party has opposed any form of new and higher taxes. However, it did not emphasize tax reduction as much as usual in the mid-term election, and instead called for the tax regime to be adjusted in line with the international standard and for the long-term fiscal balances. The GOP's stance on this major policy is now being put to the test: should it stick to tax reductions now that it has a strong position in both houses, or should it take a more flexible congressional strategy toward reducing the effective tax burden? Another key point is whether the various industries and areas will manage to reconcile their interests after the selective elimination of tax breaks, unlike in the case of the Production Tax Credit (PTC) for wind energy whose restoration remained on the agenda for a whole year after expiring at the end of December 2013.

Another major issue is whether the transportation budget bill will pass or be defeated. In the US, the construction and maintenance of federal highways are funded by the federal gas tax of 18.4 cents/gallon, a rate that has not changed since 1993 even without adjustment for inflation. Meanwhile, the drop in gasoline sales due to improved fuel economy and the spread of biofuels and hybrid vehicles are causing a major hole in the road fund. The situation is similar for the state highways, which are funded by state gas taxes.

When the federal transportation budget was discussed in August 2014, Congress failed to agree to raise the gasoline tax, or on eventually shifting from the gas tax to a toll system based on distance traveled. A lack of funds was narrowly avoided by passing a short-term budget that will last until May 2015. The use of short-term funds has persisted for five years, making it difficult to secure stable funds for investing in transportation infrastructure. Although deliberations on the federal transportation budget stagnated, at the state-level several states have raised or proposed raising the gas tax during the past year. Recent proposals for gas tax raises include those of Michigan from the current 19 cents to 41 cents in stages by 2018, and New Jersey from 14.5 cents to 25 cents. In contrast, Oregon is considering introducing a toll system, which it has been discussing at town and county levels for the past few years.

States and municipalities often serve as "test sites" for new policies prior to eventual adoption at the federal level in many areas of public policy in the US. By winning the mid-term election, the GOP will be responsible for implementing the policies as the majority party for the next two years. Whether the GOP will remain wedded to tax reduction in the discussions on raising the state gasoline tax, or whether they will respond flexibly for solving the long-term issue, will reveal the GOP's stance toward governing.

5. EU Watching: New European Commission Seeks to Strengthen Energy Security

Wataru Fujisaki, Senior Researcher
Global Energy Group 1
Strategy Research Unit

On November 1, the new European Commission led by President Juncker was officially inaugurated. In the five-year term till the end of October 2019, the Commission will tackle numerous challenges to deepen the union of the EU and revitalize the European economy. Under the motto "A New Start for Europe", President Juncker has announced three policies related to energy. First is the establishment of the "Energy Union". The threat to gas supplies to Europe caused by the crisis between Russia and Ukraine is due to Europe's high dependency on imports of oil and gas. This initiative aims to enhance the EU's ability to bargain with external energy suppliers by negotiating collectively as the EU instead of as individual firms. Second is the establishment of a new and fair European energy market. By having a highly fluid energy market, even when an energy supplier raises the energy price for political reasons, an alternative source can be quickly found, thus easing the impact of the price rise. Third is the greater use of renewable energies. Renewables will help solve not only climate change, but also the energy self-sufficiency rate in the medium to long term. President Juncker has appointed a dedicated Vice President for the "Energy Union" to implement these three policies, and has set up a new energy & climate action department by combining the existing energy and environment departments. Energy security will be the priority topic for the new Commission, which is a change from the Commission's focus on climate change.

To ensure energy security, the EU has taken various measures in its negotiations with energy supplier countries including Russia. It has promoted deregulation and made the European energy market more competitive by introducing the Third Energy Package. This requires any external energy supplier entering the European market to unbundle like the EU firms, to weaken their market power. The EU is also demanding the abolition of the destination clause for gas, claiming that it impedes fair competition within the EU, and has invigorated transactions in its energy market and established a highly-reliable market price index. In the negotiations with Russia and Algeria, the EU is wisely taking advantage of the position of Norway, which is not an EU member but shares common values as a Western country. Norway is acting in line with the EU's policies, taking the lead in abolishing the destination clause and agreeing to adopt the European Hub-linked price instead of the oil-linked price for its new LNG supplies to Lithuania.

It is not yet clear whether a new organization to purchase gas for the whole of Europe will be established based on the Energy Union, as the Commissioner for competitive markets promoting free trade within the EU considers that such an organization would be "a clear violation of EU law". The Energy Union is supported also by the new EU President Tusk. It will be interesting to see the EU's attitude toward the Union.

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)