IEEJ e-NEWSLETTER

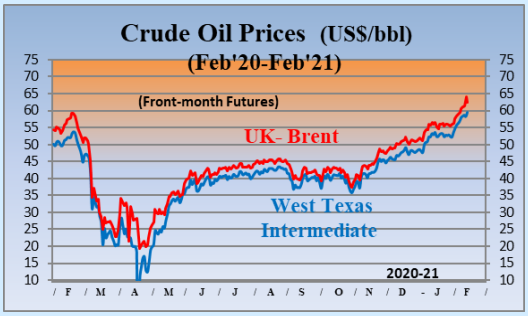
No. 203

(Based on Japanese No. 209)

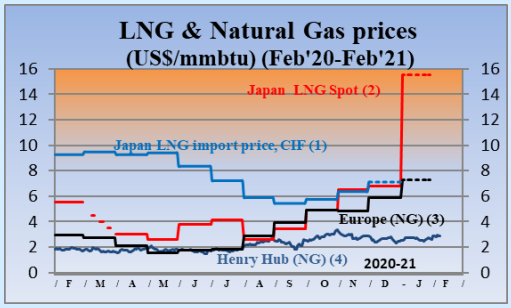
Published: February 17, 2021

The Institute of Energy Economics, Japan

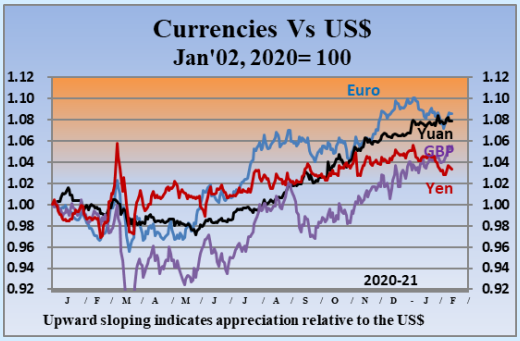
(As of February 12, 2021)



Sources:
(1) DOE-EIA
(2) Investing.com



Sources:
(1) Ministry of Finance "Japan Trade Statistics"
(2) Ministry of Economy, Trade and Industry (arrival month basis)
(3) Estimated by World Bank (Netherland Title Transfer Facility)
(4) DOE-EIA, NYMEX (Front-month Futures)



Source: x-rates.com

Sources:
(1) Finance. Yahoo.com
(2) Investing.com

Contents

Summary

【Global Monitoring】

1. US: Capacity Market and Allocation of CO2-related Costs

There is a debate in the US on subsidies for non-fossil power sources, and thus increasing interest in the reform of the PJM capacity market.

2. EU: Publication of the EU Taxonomy Postponed

Publication of the EU taxonomy rules has been delayed due to the massive number of comments received. Challenges remain, including how to handle natural gas and the difficulty of changing the real economy.

3. China: Progress in Shifting to New Energy Vehicles

Sales of NEVs increased to 1.37 million units in 2020, accounting for 5.4% of all units sold. The shift to NEVs will continue steadily, with sales expected to reach 1.8 million units in 2021.

4. ME: Activities Accelerate toward Commencement of the Biden Administration

As the start of the Biden administration neared, Saudi Arabia took the initiative to restore diplomatic ties with Qatar and lift its economic blockade of the country. Meanwhile, Iran began to enrich uranium to 20% and accelerate nuclear development.

5. Russia: Update on the West's Strengthened Sanctions

With the arrest of anti-government leader Alexey Navalny soon after returning to Russia, the US government tightened its economic sanctions on Russia yet again. The European Parliament passed a resolution calling for an immediate halt to the construction of Nord Stream 2.

1. US: Capacity Market and Allocation of CO_2-related Costs

Junichi OGASAWARA, Senior Research Fellow
Manager, Electric Power Group
Assistant Director
Electric Power Industry & New and Renewable Energy Unit

On January 20, 2021, Joe Biden was inaugurated as the new president of the United States. Before the end of the day, he signed executive orders including for commencing procedures to return to the Paris Agreement and freezing the lease of oil and gas fields in Alaska. He also appointed renewable energy policy experts in large numbers to replace politically-appointed senior officials in the Department of Energy, the Environmental Protection Agency, the Federal Energy Regulatory Commission, and other federal bodies. These measures demonstrate his determination to press ahead with decarbonizing the electricity sector. Discussions on securing investments for grid improvements needed for introducing large amounts of renewable energies and for a stable electricity system are expected to gather steam.

Amid growing interest in Japan and around the world on how capacity market auctions are operated, the review of requirements for participating in the capacity market auction at US PJM is causing major debate. In December 2019, the Federal Energy Regulatory Commission (FERC) ordered state-subsidized resources newly participating in PJM capacity market auctions to use minimum offer price rule (MOPR). Capacities already participating in the market will be subject to other rice rules. In both cases, the minimum prices will bar participants from clearing the market due to the auction price cap. These measures have been proposed and approved in response to criticisms that suppliers of renewables and other subsidized energies are shutting out non-subsidized suppliers from these auctions. Introduction of the rules has been put on hold due to differences in views between PJM and FERC.

New nuclear and both land-based and offshore wind power capacities will be effectively shut out from capacity market auctions as their minimum bid prices will be higher than the auction price caps, and so will existing nuclear power plants as their regulatory minimum price levels exceed the price caps. In PJM's areas, the states of Illinois and New Jersey have non-fossil power source subsidies called zero-emission credits (ZECs), and Ohio and Pennsylvania are discussing introducing similar systems. New construction and continuation of nuclear power will be hit particularly hard if capacities are shut out from capacity market auctions. Exelon has already announced that it will close two of its nuclear power plants in Illinois.

One aspect of this issue is what constitutes a "subsidy." Renewable power can be exempted from the rules if the subsidies were granted under the RPS system, but ZECs were recognized as subsidies since they support only particular power sources. The New York Independent System Operator (ISO) is conducting studies on forming wholesale electricity prices factoring in CO_2 costs. In this mechanism, the CO_2 costs calculated from the CO_2 emissions intensity of various power sources are added to wholesale electricity prices after they are determined in the real-time market. This mechanism, if adopted, would allow non-fossil supplies including nuclear to receive higher compensation from the energy market, raising their profitability. Encompassing several states, it is difficult for PJM to adopt a one-size-fits-all system. However, if the capacity market reform had included the system that is currently being considered by the New York ISO, it would have been praised for creating a non-discriminatory and fair market.

2. EU: Publication of the EU Taxonomy Postponed

Ichiro KUTANI, Senior Research Fellow, Manager
Global Energy Group 1 , Assistant to Managing Director
Strategy Research Unit

According to a media report (Euractiv, January 18, 2021), publication of the delegated act (equivalent of Japan's order for enforcement) for the taxonomy rules has been delayed from the initially scheduled January 1, 2021. The draft taxonomy rules were released in November 2020 and open for public comment until December. The reason for the delay is assumed to be the massive number of comments received, 46,591, which must be reviewed.

Alongside the public comments, there is also continued pressure on the delegated act from Eastern and Southern European states. Ten countries (Poland, Czech Republic, Slovakia, Hungary, Croatia, Romania, Bulgaria, Greece, Malta, and Cyprus) are jointly demanding "transition" fuel status for natural gas. They claim that all member states are entitled to select an appropriate mix of energies and technologies, and that the use of natural gas in particular as a "transition" fuel would lower the cost of transition.

Another key discussion point regarding taxonomy is the economic impact. A study conducted by Germany's Federal Ministry for the Environment, Nature Conservation and Nuclear Safety in 2020 produced interesting results. The study was conducted on the companies included in major stock indexes for Europe (EURO STOXX 50), Germany (DAX), and France (CAC 40) and analyzed what percentage of their sales come from areas defined as green in the proposed taxonomy. The results showed that sales from areas that perfectly match the definition of green in the taxonomy made up just 2% of total sales of the companies in EURO STOXX 50, 1% in DAX, and 2% in CAC 40. The percentages increased when the scope was expanded to include "related areas," but only to 20–30%, or 20%, 22%, and 27%, respectively. By company, in 77% of the companies studied, sales from areas perfectly matching the taxonomy's definition of green accounted for less than 1% of total sales. As to why Germany did not do so well, the study cites the large number of automakers and other manufacturers among the companies studied.

This result highlights the fact that economies today are largely driven by activities that have high carbon emissions. Even Europe, which has set ambitious targets and rapidly launched a series of policies under the green policy and where the majority of society seems ready to act to decarbonize, the real economy has much room for improvement. Needless to say, changing the economic structure will take time. Making a rigorous distinction between green and non-green, if done hastily, could even damage the economic foundation that underpins our lives, and could cause a large influx of capital into a handful of "green companies," causing a green bubble. This would lead to major turmoil and unwanted problems.

While climate action is without doubt essential, it would be counterproductive if it does major harm to the economy. A path to transition that is viable simultaneously for both the climate and the economy is needed.

3. China: Progress in Shifting to New Energy Vehicles

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

China is shifting from gas-fueled cars to electricity-driven new energy vehicles (NEVs, including EVs, PHEVs, and FCVs but not HVs) to achieve sustainable growth and build a carbon-neutral society. Further progress was made in 2020.

According to the China Association of Automobile Manufacturers (CAAM), automobile production in 2020 was 25.23 million units, down 2% year-on-year, with sales of 25.31 million units, down 1.9%. The size of the overall automobile market shrank for the third consecutive year due to the impact of the US-China trade war which began in 2018 and the expansion of the Covid-19 pandemic in 2020. Meanwhile, the production of EVs and other NEVs increased by 7.5% to 1.366 million units and sales grew by 10.9% to 1.367 million units (including 1,115,000 EVs, up 11.6%, 251,000 PHEVs, up 8.4%, and 1,182 FCVs, down 56.8%), making China the first country to surpass one million units for three consecutive years. The share of NEVs in all units sold increased by 0.6 percentage points to 5.4%.

Looking back, sales of NEVs had grown steadily since their commercial launch in 2009 until its first year-on-year fall in 2019. The decline is considered to be attributed mainly to the maximum 58% cut in the NEV purchase subsidy (the maximum subsidy for passenger EVs with a cruising distance of 400 km was lowered from 66,000 yuan to 27,500 yuan), in addition to the 0.5-point year-on-year fall in economic growth to 6.1% in 2019 due to the intensifying trade friction with the US. Meanwhile, in 2020, monthly sales fell year-on-year from January through June with the added impact of the pandemic but turned positive in July for the first time in 12 months. Monthly sales have grown both year-on-year and month-on-month thereafter, marking a record high of 248,000 units in December. Why did this happen?

The first reason is the decision by the Ministry of Finance and others in April 2020 to extend the subsidy period by two years, which was initially due to end within the year, and to make the reduction less steep. For example, the subsidy cap, which was initially planned to be halved to 13,800 yuan in 2020 and abolished from 2021, was lowered to only 24,900 yuan in 2020, to 19,800 yuan in 2021, and to 13,900 in 2022 as a result of the revision. In July, the Ministry of Industry and Information Technology (MIIT) and others decided to launch a campaign to boost the use of NEVs in rural areas. The aim was to expand the NEV market to rural areas by urging automakers to provide preferential treatment including special discounts. The effects were striking. Hong Guang Mini, a compact EV launched by SAIC-GM-Wuling in July (cruising distance: 120–170 km, price: 28,800–34,800 yuan (460,000–560,000 yen)) sold 33,000 units in November, the highest nationwide and 11,000 units more than US Tesla's Model 3 in second place. According to MIIT, sales of NEVs eligible for the campaign surpassed 180,000 units between August and November alone. Further, in June, the decision was made to continue the NEV regulation and credit trading system introduced in 2019 (assigning target companies with an NEV sales ratio requirement against their annual engine vehicle sales, allowing any excess or shortfall to be settled with trading credits). The target NEV sales ratio against engine vehicles assigned to automakers was raised from 12% in 2020 to 18% in 2023. These systematic improvements in promotional measures are thought to have encouraged the shift to NEVs.

In November 2020, the government published plans to raise the target ratio of NEVs in auto sales to 20% in 2025. CAAM forecasts that NEV sales will increase to 1.8 million units, and the share in all cars sold to 6.8%, in 2021.

4. ME: Activities Accelerate toward Commencement of the Biden Administration

Sachi SAKANASHI, Senior Research Fellow
Assistant Director, JIME Center

The Middle East saw a series of major moves ahead of the start of the Biden administration. First, the economic blockade on Qatar since June 2017 was lifted at Saudi Arabia's initiative. Meanwhile, Iran, which seeks an early lifting of sanctions under the Biden administration, stepped up its nuclear development. Concurrently, Iran's Islamic Revolutionary Guard Corps seized a South Korean tanker near the Strait of Hormuz in the Persian Gulf.

The restoration of diplomatic ties with Qatar was a direct result of the Biden administration. Various people in the Biden administration had been criticizing Saudi Arabia regarding its military activities in Yemen, the murder of a Saudi journalist, the arrest of a humanitarian activist, and the severance of diplomatic ties with Qatar, and Saudi Arabia presumably has sought to alleviate those criticisms before the new administration took office. On January 4, 2021, Saudi Arabia announced it would open the land borders with Qatar and on the 5th, Saudi Arabia, the UAE, Bahrain, and Egypt declared that they had agreed to normalize diplomatic relations with Qatar at the 41st GCC Summit held in Al Ula.

On the other side of the Persian Gulf, meanwhile, Iran made a move on the same day, January 4, which was also directed at the Biden administration, declaring that it was increasing its uranium enrichment level to 20% and expanding its enrichment activities at the Fordow underground nuclear plant in central Iran. Iran's intention was to press the Biden administration, which has a long list of things to do including reviving the pandemic-hit US economy, to deal with the "Iran issue" as quickly as possible. The Iranian economy has been hit hard since the Trump administration pulled out of the Iran nuclear deal (JCPOA) in May 2018 and reinstated all sanctions, which had caused Iran to declare an expansion of its nuclear development activities as "the JCPOA promises are not being kept." Accordingly, Iran raised the uranium enrichment level to 4.5% in 2019 despite the agreed limit of 3.67% in the JCPOA, and this time to 20%.

As the reason for seizing the Korean tanker, Iran cited the "marine pollution" caused by the vessel. However, it is speculated that the seizure was actually a response to the South Korean freezing of more than 7 billion dollars of Iranian assets (revenues from oil exports). Iran is demanding that the Biden administration allow Iran to resume oil exports, normalize financial transactions, and unfreeze Iran's assets in other countries, and the seizure of the South Korean ship is probably linked with the third demand. The Iranian parliament enacted a law in December 2020 to roll back Iran's cooperation with the International Atomic Energy Agency unless sanctions are lifted, and has declared a "deadline" for lifting the sanctions which will arrive in February. Attention must be paid to the response of the United States, where many of those who were directly involved in establishing the JCPOA under President Obama are now back in government.

5. Russia: Update on the West's Strengthened Sanctions against Russia

Sanae KURITA, Senior Researcher
Global Energy Group 2
Strategy Research Unit

According to the Russian government, Russia's crude oil and gas condensate production fell 8.6% year-on-year to 512.68 million tonnes (10.27 mb/d) and oil exports decreased by 11.8% year-on-year to 219.16 million tonnes (4.39 mb/d) in 2020. Natural gas production dropped by 6.2% year-on-year to 692.0 billion cubic meters (bcm), with an estimated 491.3 bcm coming from Gazprom and 72.4 bcm from private major gas company Novatek. Gazprom's gas exports to outside the CIS bloc decreased by 10% year-on-year to 179.3 bcm, including 4.1 bcm of exports to China by Power of Siberia.

The construction project for Nord Stream 2, a gas pipeline connecting Russia with Germany via the Baltic Sea, has been suspended since the Swiss pipeline-laying company Overseas pulled out of the project in 2020 due to concerns about the impact of additional US sanctions. Since then, it has become even less clear whether the project will restart.

On January 16, 2021, Bloomberg reported that major Swiss insurer Zurich Insurance Group is planning to stop providing insurance services linked to the project; a Russian insurer is expected to step in. Since the legislation of the US's National Defense Authorization Act in December last year, Zurich is the third country to pull out of the project due to the fear of sanctions, following Norway's Det Norske Veritas Holding AS and Danish engineering firm Ramboll.

The US government has stepped up its sanctions against Russia even further. On January 19, 2021, the US Treasury Department announced that Russian undersea pipeline-laying ship Fortuna and its owner KVT-RUS have been added to the sanctions list. After the arrest of anti-government leader Alexey Navalny immediately upon his return to Russia on the 17th, the US government warned Germany and other European countries about imposing sanctions on Russian pipeline-laying ships involved in the construction of the Nord Stream 2 gas pipeline.

There have also been moves in Europe. On January 21, 2021, the European Parliament passed a resolution calling on the EU and its member states to strictly review their cooperation with Russia, including on various diplomatic platforms and projects, with 581 votes in favor, 50 against and 44 abstentions. The resolution includes a demand to immediately stop the construction of Nord Stream 2 and sanctions on individuals and companies involved in the arrest of Alexey Navalny. However, the resolution is not legally binding and the reactions of EU member states vary. While Lithuania and Latvia are calling on other member states to consider sanctions against Russia, Germany remains cautious. The German authorities had released plans for Russian pipeline-laying ships to restart construction work from January 15, 2021 and to complete the first pipeline in May and the second one in June. German Chancellor Merkel has affirmed that there are no plans to abandon the Nord Stream 2 project, and said that she wants to discuss matters with Biden's new team and that her thoughts on the project have not changed even after the Navalny incident.

Past IEEJ Events

Energy and Economy 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, Managing Director**
***IEEJ j-Newsletter* Editor: Ken Koyama, Senior Managing Director**
The Institute of Energy Economics, Japan (IEEJ)
Inui Bldg. Kachidoki, 13-1 Kachidoki 1-chome, Chuo-ku, Tokyo 104-0054, Japan
Tel: +81-3-5547-0211 Fax: +81-3-5547-0223