

OIL AND GAS FOR ASIA

Geopolitical Implications of Asia's Rising Demand

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Introduction: Oil and Gas for Asia

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Asia has become “ground zero” for growth in global energy and commodity markets. The region’s rapid economic growth is driving an enormous rise in the consumption of oil and liquefied natural gas (LNG) to fuel booming motorization and industrial growth. This energy boom has been centered in China, but energy demand is rising dramatically across developing Asia and is being shaped by shifting economic, environmental, and geopolitical factors.

In the case of oil, Asia has accounted for 66% of growth in global oil demand over the past two decades. Moreover, according to the 2011 *World Energy Outlook* by the International Energy Agency, Asia is likely to account for over 85% of the entire increase in demand over the next twenty years—with virtually all demand growth occurring in developing Asia. Furthermore, Japan and South Korea remain 100% dependent on oil imports, China now depends on imports for more than half of its oil needs, and India and Southeast Asia also depend on imports for three-fourths of their oil needs.

At the same time, Asia’s demand for oil imports has chronically bumped up against a very tight global oil-supply environment. New growth in oil supply around the world has barely exceeded declining production in the world’s large older oil fields, leading to very slow overall net supply growth. Moreover, the geopolitics of oil are deeply worrisome, characterized by strong resource nationalism, shrinking access to new oil resources that is driven by political factors, chronic geopolitical instability in key exporting regions, and what many call the end of the era of “cheap oil.” The oil price spike of 2006–8 intensified this view of an increasingly zero-sum future oil environment, which Asian countries fear could seriously threaten economic prosperity. Although oil prices declined with the U.S. and European Union (EU) financial crisis after 2008, prices are again on the rise with the gradual, albeit uncertain, global economic recovery.

Asia’s natural gas consumption has also been rising strongly over the past decade to fuel booming industrial needs and power generation. Asia accounts for 70% of the worldwide LNG market, and global demand for LNG has been growing in excess of 10% per year. In effect, strong demand, combined with oil-linked LNG pricing, has driven prices higher in the Asia-Pacific. This phenomenon has been severely aggravated by a spike in demand from Japan as the country scrambles to meet its electricity needs in the wake of the virtual total shutdown of its nuclear generation capacity. The so-called Asian premium for LNG has been driven to extreme levels. There is also growing concern about LNG supply availability, particularly until 2016, when new projects around the region will begin to expand supply.

Consequently, angst over high and volatile prices, as well as over the availability and reliability of future energy supplies, is a critical driver of the strategic and economic agendas of Asia’s powers. The region’s major states have responded with a state-driven approach, characterized by national competition to control future supplies through governmental support of investments abroad by their own national oil companies (NOC), expanding oil diplomacy, oil pipeline projects to feed national markets, growing competition for potential future offshore supplies, and concern over the security of sea lanes. Rather than seeking ways to cooperate to find common regional solutions to these problems, the region’s powers have increasingly embarked on a national competitive approach that intensifies distrust, worsens maritime tensions, and aggravates key strategic rivalries. Asia’s scramble for resources also risks pushing oil and LNG prices even higher and strengthens producers in using energy for political and diplomatic leverage.

The region’s quest for more secure oil and LNG supplies is also driving it toward greater dependence on and engagement in key oil- and gas-exporting regions, most importantly the Persian

Gulf and Middle East. This reliance is drawing Asia, especially China, into much more powerful diplomatic roles in these regions. The tug of war over Iran's nuclear ambitions is a perfect example of how Asian powers are being pulled into critical diplomatic roles: Japan, South Korea, India, and China are the major buyers of Iranian crude oil, and U.S. goals on oil sanctions cannot be achieved without their participation. More broadly, U.S. dependence on oil imports from the Persian Gulf and Middle East is likely to continue to decline as available supplies in the Western Hemisphere are increasing. How will these shifting dynamics reshape the global geopolitics of oil and gas? The United States has historically been the major power in shaping Middle East and Persian Gulf developments, but it will increasingly depend on Asian powers, especially China, to achieve its goals in the region. What are the implications of this trend for U.S. strategic interests and foreign policy?

To address these issues, the National Bureau of Asian Research (NBR) and the Woodrow Wilson International Center for Scholars co-hosted NBR's eighth annual Energy Security Workshop in Washington, D.C., on May 11, 2012. Building on NBR's ongoing initiative to bring together policymakers, industry leaders, and key stakeholders concerned with Asia's energy geopolitics, the annual workshop convenes senior specialists for high-level discussions on the future of Asian energy markets. The arguments presented at this event are then used to inform discussion throughout the year, as well as this final report. This year's program—"Oil and Gas for Asia: Geopolitical Implications of Asia's Rising Demand"—focused on the implications of Asia's oil and energy security challenges and their impact on U.S. geopolitical and energy security interests. We are grateful for the generous support of our sponsors—Chevron, ConocoPhillips, ExxonMobil, and the Japan Oil, Gas and Metals National Corporation—whose contributions enable us to examine the central energy security challenges facing the United States and the Asia-Pacific today.

To explore these themes in depth, NBR commissioned essays to stimulate program discussions, which were then strengthened and advanced by insights from the workshop. Each essay addresses a key issue emerging from the changing energy landscape: (1) the geopolitical implications of the shift in global oil demand toward Asia, (2) what the dispute over Iran sanctions says about the new balance of political influence in the Persian Gulf, (3) whether state support for the expansion of Asian NOCs serves their countries' energy security, and (4) how Asian LNG markets are being reshaped by Japan's demand shock and shifting LNG supplies. This NBR Special Report comprises these four essays, along with a conclusion drawing implications from the program about the impact of Asia's quest for more secure oil and LNG supplies on U.S. energy security and strategic interests.

In the first essay, John V. Mitchell from Chatham House in London provides a superb overview of how the shift in the balance of oil supply and demand from the United States and the EU to Asia is affecting global energy security. Given changes in the global oil trade in recent years and industry projections, the United States and Atlantic countries are no longer directly dependent on oil imports from the Middle East. Thus, the risks of supply disruption and political leverage from the Middle East are now concentrated on Asian oil markets, which have become the primary destination of Middle East oil. Disruptions in the Persian Gulf would expose all importers, including the United States, to price risks but not physical risks. The implications are substantial. How long will the United States maintain its historic commitment to ensuring political stability and open sea lanes in the Middle East, given its declining oil dependence on the region? Will the Asian powers, including China, step in to support political stability and secure the sea lanes in the future if the United States reduces its commitment?

Next, Zha Daojiong from Peking University in Beijing affords exceptional insight into Chinese views of the current U.S.-led effort to pressure Iran to change course on its nuclear energy ambitions. As a way to intensify economic pressure on the regime, the United States is building an international coalition to squeeze Iranian oil exports. While many other major oil importers—Japan, South Korea, and even India—have promised to cut their imports of Iranian oil, China has been much more resistant to such efforts. Zha suggests that although there are historical ties between China and Iran, this geopolitical relationship and the influence that one country has over the other have often been overstated. Instead, Zha argues that Beijing feels that it needs Iranian oil supplies for economic development, it is abiding by existing UN sanctions, and a case has not been made for violations that would warrant additional sanctions. Thus, China’s resistance to cutting imports of Iranian crude is not an effort to undercut U.S. interests in the region, as some observers in the United States believe. Moreover, Beijing, which has itself been subject to U.S. sanctions, contends that sanctions are largely ineffective, and it maintains a strong aversion to intervention in the internal affairs of other states. Yet China has also been sensitive to U.S. concerns and has limited the investments of its oil companies in Iran to avoid aggravating relations with the United States. In this respect, Beijing has taken a pragmatic, utilitarian approach to balancing its relations with the United States and Iran.

Philip Andrews-Speed from the Energy Studies Institute of the National University of Singapore offers a timely assessment of whether the Asian model of governments supporting NOCs in the acquisition of overseas oil and gas production is an effective and sensible energy security strategy. China, India, Japan, South Korea, and Malaysia have all boosted support for their NOCs and NOC global investments over the past decade. Many leaders believe that their country’s energy security is enhanced by their NOCs having equity ownership stakes in oil fields around the world, and that this expands “national control” of oil supplies. Such investment also tends to feed the fears in the United States that Asian NOCs undermine U.S. access to vital oil supplies. Is this strategy effective in strengthening oil security, or is it an illusion? Andrews-Speed suggests that while the political leaderships in Asian countries continue to support their NOCs in the belief that they do strengthen energy security, NOCs do not in fact significantly strengthen supply security. Global oil markets are now deeply integrated and not subject to national supply cutoffs. Moreover, seaborne supplies can still be interdicted on the high seas in wartime, and pipelines can be blown up. Supplies can be further disrupted by unexpected political instability in producer countries or by capricious contract changes. Nevertheless, Andrews-Speed feels that Asian governments are likely to continue this strategy as long as high oil prices and instability in the Middle East feed their anxieties over market shocks and these countries’ view their NOCs as valuable “national champions” of industry.

Finally, Tomoko Hosoe from FACTS Global Energy and the East-West Center provides an excellent overview of future prospects for LNG markets in Asia in the context of rising competition for regional supplies, the Japan nuclear crisis, the continuing Asian LNG price premium, and the potential emergence of the United States as an exporter of shale gas LNG. Asia has been depending on rapid growth in available LNG supplies to meet its rising future energy needs, particularly for new, cleaner-burning electricity supplies. Hosoe argues that Japan’s nuclear crisis and the subsequent, unprecedented shortfalls in power generation have had a major impact not only on Asian LNG markets but also on global energy markets. As a result of the disruption in nuclear power generation, Japan’s demand for LNG, as well as oil for power generation, increased dramatically in 2011 and will rise even higher in 2012. Japan, once considered a mature and saturated market, has now become a renewed growing market and will remain the world’s biggest importer of LNG for the foreseeable

future. Moreover, Japan's rising LNG needs have already begun to aggravate concerns over energy security among other Asian LNG buyers. These concerns will likely persist for at least the next five to six years, until more supplies become available from major new LNG projects. Toward 2020, North American shale gas supplies—specifically, LNG from the United States—could play a key role in meeting Asia's needs for supply diversification.

Overall, the program essays, presentations, and discussions presented a broad picture of the major geopolitical changes affecting energy security in the Asia-Pacific, the Middle East, and North America today. Their findings collectively suggest that Asian and global oil and LNG markets are changing rapidly, with significant consequences for relations among the key powers in Asia, as well as for the role of the United States in global energy geopolitics. With this in mind, it is important that key stakeholders begin working together to foster innovative, collaborative solutions to common energy challenges.