

# Northeast Asia's Energy Future and the Global Political Economy

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Supplying energy to Northeast Asia is a high-stakes issue—for both that dynamic yet volatile region, and for the broader world. Japan, Korea, and China all have, in varying ways, a radical dependence on imported energy that becomes ever more painful as their growth proceeds and prices rise. For the global political economy, the energy demand of these three countries is a crucial driver for both energy prices and ultimately for world economic growth as well. Indeed, China alone accounted for a full 40 percent of the increase in world demand for oil during 2003, contributing significantly to the sharp rises in oil prices of the past year.

Energy, as is often remarked, is truly the Achilles Heel of Northeast Asia. Japan, Korea, and Taiwan—which together produce over a sixth of global GDP—have not a single major oil or gas field among them. Mainland China has significant oil and hydro-electric capacity, but it is located largely in the North and the West of the country, while energy demand is largely in the South and East. And energy infrastructure—power-transmission lines, railways, pipelines, and electric-power generation equipment—remains woefully inadequate and under-developed, in that explosively growing nation.

As Northeast Asia grows, its demand for oil, in particular, soars much faster, fueled by the consumer revolution sweeping the region. Well over a million cars annually

are sold now in the nations of ASEAN, and roughly that number in China—well over double the levels of just five years ago. Consumer appliances, including air conditioners, further contribute to rising demand. Petrochemical industries, and the related use of plastics and fertilizers, are also surging region-wide, spawning further demand for oil.

Northeast Asia's thirst for energy goes far beyond petroleum. As its economy grows explosively, the region ravenously consumes ever larger amounts of coal and natural gas also. Yet those too are in short supply. The nearly inevitable result: deepening energy crisis in a region representing a fifth of the global economy, and an ever larger share of its energy demand.

From the global perspective, Northeast Asia is also looming increasingly large. Its share of global primary energy demand, which was less than 17 percent in 2000, is expected to rise to well over 21 percent by 2030. Its growth in oil demand over the past twenty years has been more than four times the global average, while its natural-gas demand growth has been more than five times as fast. In some areas, such as liquefied-natural gas (LNG) Northeast Asia's market has become overwhelmingly important, with a full two-thirds of global LNG supply currently flowing to the region.

The distinctive Middle East-Northeast Asian linkages also make Northeast Asia's energy picture globally important from a geo-political perspective. Japan and Korea both get between 70 and 80 percent of their oil from the Middle East, and China roughly 50. The United States, by contrast, gets only 23 percent of its oil from that volatile region, and Europe even less. Conversely, the Middle East ships half of all its energy exports to Northeast Asia, and this share is likely to rise in coming decades. There is an deepening

“Middle East-Northeast Asia axis” in global energy markets that has profound, yet as yet unappreciated importance for global affairs of the 21<sup>st</sup> Century.

Two transcendent realities need to be considered in thinking systematically about Northeast Asia’s energy future. Most importantly, that economically and geo-politically crucial region is a part of a larger global system, albeit an increasingly substantial part of that whole. Secondly, Northeast Asian energy problems have some highly distinctive aspects, justifying region – specific analysis and policy solutions.

That Northeast Asia is just a component in a global integrated political – economic system is a commonplace. Yet it is nevertheless an important point easily lost in regionalist dialogues. The logic of intra-regional energy dialogue, for example, must come to terms with the reality that two-thirds of global proven oil reserves are in the Middle East, with marginal production costs far lower than in Northeast Asia. Middle Eastern shares of global gas reserves are lower, but still very substantial.

These realities certainly do not obviate the potential need for intra-regional projects within Northeast Asia. Ongoing political uncertainties in the Middle East, and the dangers of terrorism across the long sea-lanes from the Persian Gulf, of course greatly enhance the logic of Northeast Asian energy projects. Yet the globally competitive cost position of the Middle East, and the prospect of a stable resolution to its political troubles, need to be factored into debate on the ultimate feasibility of Northeast Asian regional projects also.

Energy security and geopolitics also need to be realistically factored into the regional equation. What configuration of supply provides optimal assurance to consumers that they will receive energy at reasonable prices, in environmentally

acceptable forms, as far as possible into the future? Undue reliance on single suppliers, or a small number of suppliers, in rigid, institutionalized form, can clearly have undesirable aspects, especially should suppliers decide to use energy supply, and terms of supply, as a strategic weapon. This happened during the 1970's in oil, of course, when tight markets provided undue market power to the OPEC cartel. The possibility that it could happen in natural gas, should consumers be tied too rigidly to individual suppliers, deserves further consideration. And the potential dangers are substantial for East Asia, given its heavy overall dependence on imported energy.

Japan, Korea, and to a lesser degree China are all heavily dependent on Middle Eastern oil. Market forces have driven this dependence, and must be considered in reducing it. Yet there clearly is a powerful energy-security argument for *diversification*.

Diversification toward Russian gas and toward a Northeast Asia electric-power grid that supplies secondary Russian energy to the region, have been widely proposed as appropriate lines of diversification. I myself have strongly supported this line of development in past, and applaud the gradual realization of the Sakhalin energy projects. Recent agreements to supply Russian energy to the U.S. West Coast also seems far-sighted and stabilizing from a geo-political perspective. Deeper mutual interdependence between Russian and its Pacific neighbors is certainly to be applauded, as long as it emerges within the context of broad, diversified sources of supply for the consumers involved.

Diversified supply sources seem more important today geopolitically than five years ago, for two fundamental reasons. First, markets are tighter than they have been, with prospects that high intra-regional growth in Northeast Asia can be sustained.

Secondly, there appear to have been changes in government-business relations and in the relationship of energy to national strategy within Russia. To the extent that energy policy is a tool of national geopolitical purpose in producer nations, consumers logically need to consider ways of offsetting the leverage that tight markets and concentrated state dominance in energy contract determination accord to those producers.

The concrete implication of tight markets and more centralized, statist Russian energy policy making is not to depreciate the importance of Russia-related gas and electricity projects. Their logic remains strong. It is, however, increasingly important to appreciate the value of broad multinational projects – of which those now underway in Sakhalin are an example – involving major United States and European firms. Their involvement broadens potential product markets, and increases leverage for all consumers in Northeast Asia and elsewhere. Fortunately Russian policies toward foreign investment appear more pragmatic and forward-looking than has often been true in the past, even as the Russian energy policy process itself seems to be growing more centralized.

Moving beyond energy, regional development projects in general are very much needed. Yet they cannot afford to be myopic in their consideration of either security issues or the relations of Northeast Asia to the broader world. For the United States, and also for Japan, resolution to the North Korea nuclear issue on terms that do not intensify nuclear proliferation globally is crucial. A Grand Design for the region is a laudable goal, with prospectively positive implications for global growth and prosperity. Yet it needs, realistically speaking, to be tied to a successful resolution of the ongoing Six-Party Talks.

Indeed, a successful resolution to those talks could hopefully provide substantial momentum to a Grand Design. Such a plan also, however, needs to be attractive to key political and economic actors in all the major nations of the North Pacific, including the United States, as well as in Asia itself, if they are to be expected to proactively support it. An overly narrow political-economic conception of such a design will relegate it to the realm of idealistic but impractical schemes that have been too common in Northeast Asia's past.

There are important groups in the United States and Europe - including energy firms, construction companies, investment banks, and private-equity investors - who have a potential stake in Northeast Asia development. Such development, of course, first and foremost serves the legitimate interests of the people of the region. To safeguard their interests, new institutional forms like the Northeast Asia Development Bank (NEADB) should be seriously considered. But development plans may well be easier to realize, and substantially more congruent with the real interests of consumers in the region, if they take a sophisticated view of the political-economic equations outside Northeast Asia, as well as within it.