

Future Russian Energy Supply to Northeast Asia: A Japanese View

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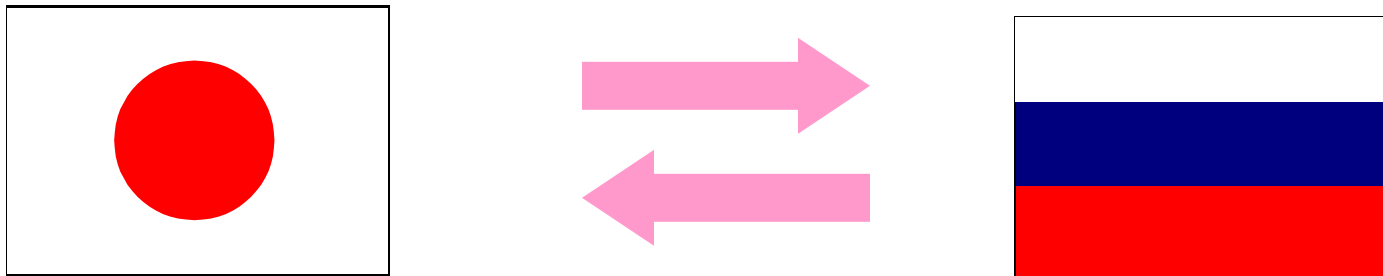
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Main Points

1. Tokyo obviously places a strategic importance on increasing energy supply from Russia, although its expectation has somewhat weakened recently.
2. Skepticism toward Russia's intension to raise energy supply to Asia is strong in Japan because of lack of detailed development plan and insufficient investments in eastern Russia, and the rise of "resource nationalism".
3. In the next decade, Russian LNG supply to Japan may expand, although oil supply may not significantly increase.
4. Key factors to drive Russian energy exports to Japan are improvements in investment climate in Russia, risk absorption capacities of Japanese oil industry, and good Japan-Russia bilateral relationships.

Mutual benefits of Russian energy supply to Japan

- ▶ Japan and Russia Japan should find mutual benefits in expansion of Russian energy exports to Japan.



- Diversification of import source
- Geographical proximity
- Market transparency and removal of “Asian premium”
- Diversification of export market
- Securing another stable and reliable market
- Economic development in eastern Russia

Japanese views about Russian energy resources

▶ Government

- Tokyo attaches high importance to the Russian energy resources.
- Its expectation about future Russian energy supply, however, has somewhat weakened in the last two years.
 - The primary focus of Japan's resource diplomacy shifted to Gulf and African countries.

▶ Private companies

- Most Japanese private oil companies are not very much eager to invest in Russian energy projects compared to other investment opportunities.
- Besides political risks of Russia, their shortages of engineers and limited risk absorption capacities also discourage their investments.
- Some trading houses, however, are interested in non-operator equities of future LNG projects.

Japanese views about Russia's intentions

- ▶ Skepticism about Russia's intention to export energy to Northeast Asia is still strong.
 - Lack of specific development plan in eastern Russia
 - Insufficient exploration investments in eastern Russia
 - Reluctance to utilize foreign expertise
 - Delay of ESPO construction
 - Inconsistency among policies of different government organizations
- ▶ Russia may become more interested in deepening economic ties with Japan.
 - Japanese technologies to diversify its resource dependent economy and strengthen competitiveness of its nuclear industry
 - Japanese capital to develop eastern Russia
 - Forming a new balance of power in Far East

Territorial issue

- ▶ Territorial dispute over the northern islands is the biggest obstacle to deepen Japan-Russia economic ties.
 - President Putin takes a hard-line attitude toward this issue especially after he was re-elected in 2004.
 - A large scale economic cooperation from Japanese government may be politically difficult unless this issue is settled.



Outlook of Russian energy exports to Japan

▶ Oil

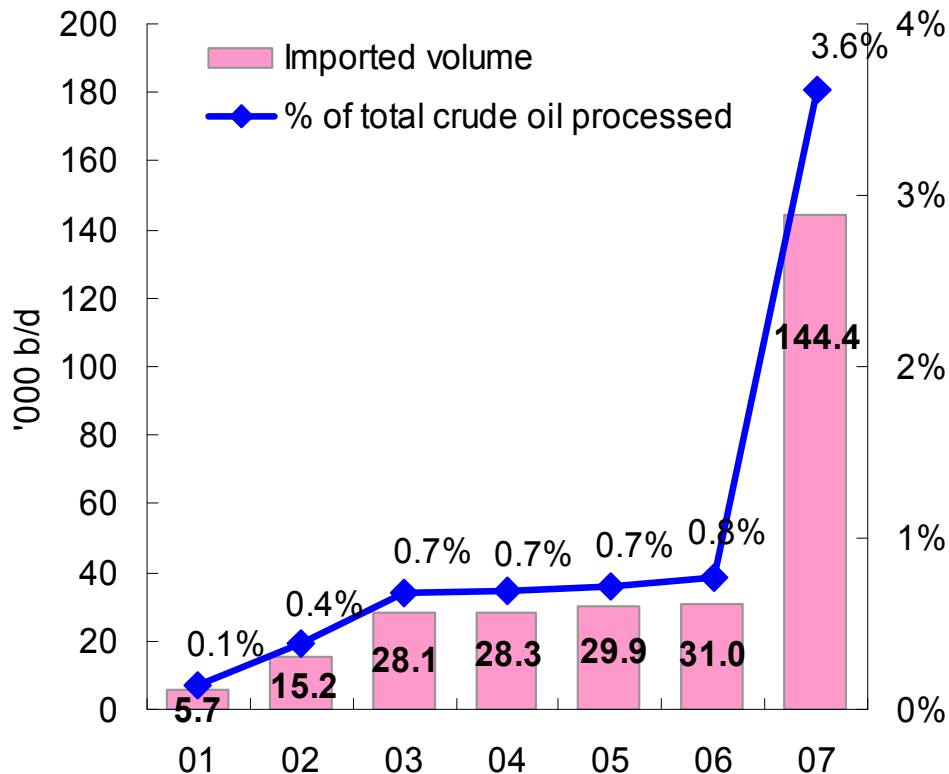
- Oil exports to Japan will remain flat at best in the next five years.
- Oil exports may increase in the next ten years on conditions that sufficient oil reserves are secured in eastern Siberia, ESPO pipeline is completed, and crude oil is sold at a competitive price.
 - Some practitioners argue that the quality of Siberian crude oil is too high for Japanese refiners to process.

▶ Natural gas

- LNG exports from Sakhalin-2 LNG will be supplied to Japan as contracted. LNG exports from Sakhalin Island has a potential to grow subject to the development of the other Sakhalin projects.
- It is not realistic to assume that natural gas pipeline will be built from Russia to Japan in the next decade.

Outlook of Russian energy exports to Japan (Cont.)

Japan's import of Russian crude oil



Source: IEEJ

LNG contracts of Sakhalin-2

Company	Duration	Volume (mil t/y)
TEPCO	2007-29	1.5+option
Tokyo Gas	2007-31	1.1
Kyushu EP	2009-31	0.5
Toho Gas	2010-33	0.5
Hiroshima Gas	2008-28	0.214
Tohoku EP	2010-30	0.42
Chubu EP	2010-30	0.5
Saibu Gas	2011-26	0.0085
Shell Eastern Trading	2008-28	1.6
Kogas	2008-28	1.5+option

Source: IEEJ

Factors to drive Russian energy exports to Japan

1. Improvement of investment climate in Russia
2. Russia's political commitments to develop energy resources in eastern Russia
3. Risk-absorption capacities of Japanese oil industry
4. Japan-Russia diplomatic relationships

Thank you.

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