

Keynote Address (Abridged)

The Situation for Russia and Japan-Russia Relations

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The situation in Ukraine is casting a shadow on current Japan-Russia relations. First I shall give a simple review of the situation in Ukraine, and then I would like to explain what direction Japan-Russia relations are heading in.

The origin of the Ukraine problem is an economic problem. The countries of the EU had been seeking the conclusion of a "Ukraine-European Union Association Agreement" to attempt to bring in Ukraine. On the other hand, it appears that the Russian side wants to position Ukraine in its own sphere of influence, and is making efforts for its incorporation into the "Eurasian Economic Union". In November 2013, when Ukraine announced the postponement of signing an association agreement with the EU, large-scale opposition gatherings broke out in Ukraine, and led to the collapse of the Yanukovich regime and to the setting up of a pro-Western interim government. The association agreement with the EU had the aim of harmonizing economic systems, and not just of lowering tariffs. On the other hand, the Eurasian Economic Union was not only a liberalizing move for goods, services, and capital between Russia and Ukraine, but something aiming at the harmonization of economic policy.

Under these circumstances, Crimea was annexed in March 2014, and in eastern Ukraine a conflict between Ukrainian troops and pro-Russian factions has been underway, in a format where Russia supports the separatists. Against such a backdrop, the US and EU announced a series of economic sanctions, and Russia also has taken countermeasures against the US and EU.

Regarding the current state of the situation in eastern Ukraine, as a positive move the Minsk agreement was signed, including a ceasefire, on 5 September. The agreement itself was fragile, and the separatists strengthened their offensive further, and expanded the region they occupied. On 26 October elections were held in Ukraine for the Verkhovna Rada (Supreme Council), but voting did not take place in the areas occupied by the separatists in Donetsk and Luhansk Oblasts, with the separatists declaring the holding of an election on 2 November in both oblasts.

Against this background, there is the question of how important Ukraine is for Russia's security. Russia is intrinsically a country that has a strong defensive consciousness, resulting in distrustfulness toward the West building up, including with the eastward expansion of NATO in recent years. For Russia, keeping Ukraine under its influence is a vitally important issue.

There is the point of view of this subsequently becoming a frozen conflict. There are a number of precedents for this. For example, in Transnistria (Trans-

Dniester), in Moldova, ethnic Russian residents revolted in 1991, receiving support from the Russian military, and armed clashes broke out. The following year, armed clashes came to an end via a ceasefire agreement, but Russian troops were stationed there, and to the present day Moldovan control doesn't extend there. A similar thing happened in Abkhazia and South Ossetia in Georgia in 2008. It appears that Russia wants to maintain its own influence east of a line connecting the Russian enclave of Kaliningrad with Abkhazia and South Ossetia in Georgia, and it is expected that it will require a very long time for the substantive resolution of these problems.

Russia's position of maintaining a sphere of influence or being ready to redraw national boundaries by force can only be called a challenge to the existing order. This has major significance for Japan too; that is, from the perspective of the rule of law. Not recognizing changes by force to the current state of affairs forms the bedrock of international order, and is something also recognized in international law. Furthermore, when considering the significance that this situation has for the Asia-Pacific region, it cannot be overlooked by Japan either. With this fact, Japan too has participated in sanctions alongside Western nations.

Sanctions are largely divided into the two types of asset freezes and production by sector, and for the sector-based there are the three areas of finance, energy, and defense. The fundamental thinking behind sanctions is the heightening of the economic cost to Russia over the medium-to-long term, and they are not aimed at stopping all short-term operations. As punitive measures in the financial sector, they basically target such things as the suspension of financing and the suspension of bond issuances with which Russia procures funds, but the financing for existing projects has not stopped. The targets for bans are strictly the financing and bond issues for new projects. Regarding energy, sanctions are not imposed other than on oil development using the very latest technology, namely, deep-sea and Arctic Ocean oil exploration and production, and shale oil.

Japan has also taken similar measures, and launched into sanctions by sector in September. However, these are the defense sector and the funding procurement sector in Russia, and Japan has not taken punitive measures concerning finance. Regarding the energy sector, Japan has not adopted a single measure.

As an effect resulting from these measures, President Putin obtained from the Federation Council the authority for the exercise of force, and after the military thrust toward Ukraine grew fierce, Russian stocks and the ruble exchange rate have been falling continuously. Economic growth stalled at 0.8% in the second quarter of 2014, and the

economic outlooks of every international institution have been revised downward. The net capital flight for the first and second quarters of 2014 was US\$74.6 billion, and has reached approximately half of the amount at the time of the Lehman Shock.

In addition, I would like to point out the symbolic example in response to the neighboring countries which Russia wants to keep in its sphere of influence. At the UN General Assembly in March 2014 the "Resolution on the Territorial Integrity of Ukraine" took place. The nations in favor were firstly Ukraine, and Moldova, Georgia, and Azerbaijan, and each of them had had some form of military clash with Russian armed forces. If this goes on, such countries will increasingly move in a direction away from Russia. The Central Asian nations friendly with Russia either abstained or were absent, and those that voted against were Russia, Belarus and Armenia only.

As to Russia's future approach, it should work on strengthening its clout by enhancing its appeal, and not maintaining a sphere of influence by force. Russia possesses talented human resources, and not just energy resources. Russia, via using such soft power effectively, will be able to become a more appealing country, and Russia's leadership should recognize that the centripetal force in international society will rise via shifting to that way of thinking.

Meanwhile, how should the Western side handle Russia? I would like to point out the Commencement Address which John F Kennedy made in 1963 at the graduation ceremony of the American University. It is well known that the then relations between the West and Russia were in crisis after the 1962 Cuban Missile Crisis, but this speech is often called historic and one which transformed relations with Russia. That is: not to see only a distorted and desperate view of the other side, not to see conflict as inevitable. He called on focusing on mutual benefit, and continuing to think about overcoming differences. After the speech, regarding US-Soviet relations, a dialogue actually began from the US proposal, and led to the signing of the Partial Nuclear Test Ban Treaty. It was a speech which set the tone for the United States and Soviet Union subsequently to resolve a variety of issues through dialogue.

Turning our attention to today's world, I would like to point out the opinion piece by the columnist Thomas Friedman in *The New York Times*. It concerned the differences between Reagan and Obama, and in Reagan's time, if the Berlin Wall were torn down, there were citizens on the other side thirsting for capitalism and personalities like the Nobel Peace Prize Winners Gorbachev and Lech Walesa. Today, however, when the existing order was toppled in the Middle East, the world became chaotic, with extreme Islamists and inter-tribal conflict. The import of the column is that international society has to face this, mobilizing all its wisdom. In today's world, the issues are considerable for which cooperation with Russia is obligatory, including the problem of Islamic State.

The standpoint of the Japanese government has been

to take a series of measures against Russia in its relations with Ukraine, and at the same time to continue engaging in dialogue with Russia.

Next, I would like to talk about Japan-Russia bilateral relations. Between Japan and Russia summit meetings have taken place five times from 2013 to Sochi in 2014. President Putin's visit to Japan this autumn hasn't been realized as of the current point in time, but dialogue is continuing, and recently a summit meeting took place after a long hiatus at ASEM, and is consistent with the full-fledged summit meeting which will take place at APEC in November.

Within the trade volumes between major nations, it can be seen that, in comparison with trade between China on the one hand and Europe and the United States on the other, Sino-Russian trade is smaller by far (US\$88.8 billion in 2013), and Japan-Russia trade is yet smaller (US\$33.2 billion in 2013). Moreover, the largest partner for Russia is Europe (US\$417.5 billion in 2013).

Between Russia and Europe, while Europe's gas import demand will go on increasing to 2030, imports from Russia have been decreasing every year. When the situation in Ukraine is added in, this trend will grow stronger. Against such a backdrop, Russia is striving for the eastward export of gas.

At the May Putin-Xi Jinping summit in Beijing, a deal was signed on the supply of gas via the eastern route to China from eastern Siberia. The period of the contract was for 30 years, and the volume to be supplied was over 35 billion cubic meters, but the gas price and the time it would commence were not disclosed. We think that the supply of gas to China is ample at the current point in time, and we take it that China is not in any hurry on the substantiation of the agreement. In the current situation, Turkmenistan accounts for upward of 50% for the source of China's gas imports, and Russia remains at the 0.5% level. Russia is working on gas exports to China, including not only the eastern route, but the western route as well.

Taking a look at the trends in trade volume between China and Russia, the Treaty of Good-Neighborliness and Friendly Cooperation between the People's Republic of China and the Russian Federation was concluded in 2001, and furthermore after the border issues were resolved in 2004, the volume of trade rose sharply. The trade volume between Japan and Russia was US\$33.2 billion in 2013, and had grown 10-fold compared to the time in 1997 and 1998 when the Krasnoyarsk and Kawana Summits took place. In addition, given the fact the bilateral trade volume (US\$14.9 billion) in 2004, when the Sino-Russian border issues were definitively resolved, was half that at present between Japan and Russia, with the environment already sufficient for concluding a peace treaty between Japan and Russia also, it is expected that trade volume will continue increasing dramatically due to the conclusion of a peace treaty.

[Translated by ERINA]

Keynote Address (Abridged)

The Energy Relationship between Japan and Russia

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Japan and Russia have now reached a somewhat difficult period, but even given such a period they are engaging in direct dialogue, and I think it is highly important that we exchange candidly our mutual points of view and opinions. As for myself, I would like to talk about the Japan–Russia energy projects to date, and future energy projects.

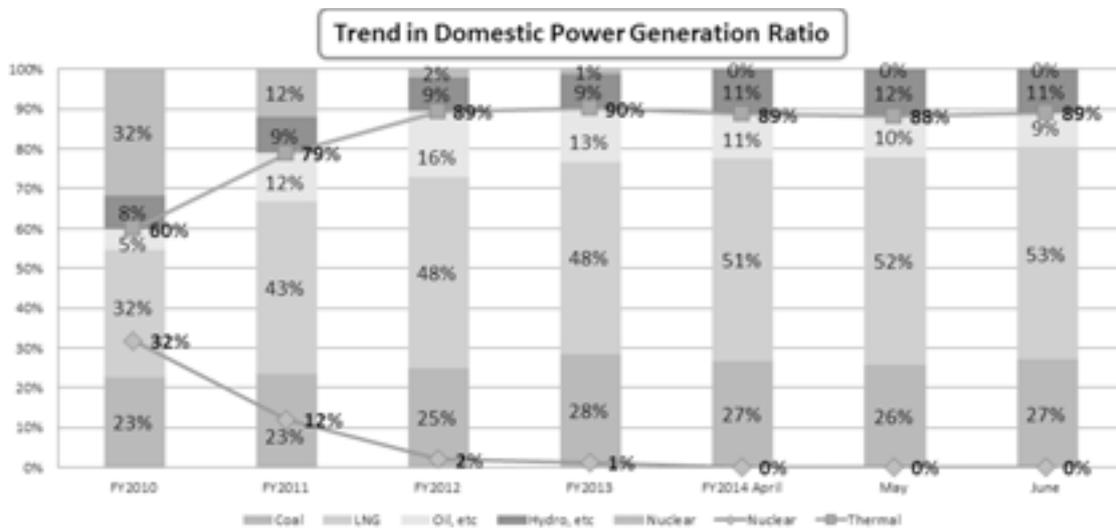
First, I would like to talk about Japan’s recent energy situation. Gas has become particularly important for Japan’s energy policy, accompanying the change in the energy situation since the earthquake disaster, in which a nuclear power accident occurred. There was a balance for the structural shares for the fuel for Japan’s electricity generation in fiscal year 2010, before the earthquake disaster, of: nuclear power, 32%; LNG, 32%; and, coal, 23%. In 2011, however, with the earthquake disaster, nuclear power generation halted, and LNG came to exceed 50%.

With the consumption of LNG greatly increasing, a number of problems emerged. In particular, the cost of LNG procurement became high. Japan imported 71 million tonnes of LNG in 2010, but it increased approximately 25%, with 88 million tonnes in 2013. From the viewpoint of 2010 the unit price for LNG has also risen greatly, and was around US\$11 per million BTU in 2010, and has increased around 50% to approximately US\$16 for 2013 and 2014. Moreover, the depreciation of the yen has progressed recently: the total purchase price for LNG in 2010 was 3.5 trillion yen, but doubled to 7.1 trillion yen in 2013. In this fashion the procurement cost for LNG rose,

and for 2011 Japan recorded its first trade deficit in 31 years. Consequently, continuing to lower the procurement cost for LNG, while of course securing gas, became a new policy aim. The Japanese and Russian governments have discussed LNG imports from Russia, and we are always talking to the Russian side about an LNG supply which is competitive for us.

In such circumstances, a move to reduce LNG imports somewhat has also been emerging. This is the restarting of nuclear power. Currently, requests for the restarting of 20 reactors have been submitted to the Nuclear Regulation Authority. Among them, 2 reactors at the Sendai Nuclear Power Plant in Kagoshima Prefecture have obtained permission, and currently a number of adjustments are being carried out. When one nuclear reactor is working, it is equivalent to approximately one million tonnes of LNG, and we expect that if nuclear power generation is operating then the volume of LNG imports will gradually decrease.

In addition to LNG, Russia is a highly important nation for Japan regarding oil also. Looking at the share of oil imports by country—Saudi Arabia, the UAE, Qatar, Kuwait, Russia, and Iran—there are many Middle Eastern countries, and the degree of dependency on the Middle East has continually exceeded 80%. The decentralizing of procurement sources is an important policy objective, but the oil-producing countries are above all concentrated in the Middle East. As for countries outside the Middle East, Russia accounts for 7%, the largest share, and is in a key position. In the case of gas, with the degree of dependency on the Middle East at approximately 30%, diversification



Source: Compiled by METI through power company hearing etc



has been progressing, but Russia accounts for 10% within that. Whether for oil or gas, Japan and Russia's is an important relationship.

Speaking of projects between Japan and Russia, first we have the Sakhalin I project. Oil exports have been undertaken since 2005 for this. For the Sakhalin II project oil exports commenced in 1999, and LNG exports commenced in 2009 also. Furthermore, the ESPO (Eastern Siberia–Pacific Ocean) pipeline connects up to Vladivostok, and crude oil is being supplied.

In addition to Russia having abundant oil and gas, the fact that the Far East region is geographically close has become a key point. Japan's demand for LNG increased in connection with the earthquake disaster, and Sakhalin II LNG has increased greatly owing to the fact that the operations are easy to bring it to Japan without taking that large a number of days. Russia has the capacity to play a very important role in both normal times and times of tension.

In such circumstances, several projects have been discussed between the Japanese and Russian governments. First, the construction of the Yamal LNG project has begun in part. The supply to Japan, being far off, is not clear at the present stage, but Japanese engineering firms are participating in the construction. Next, although the existence of oil is not necessarily clear in the case of Magadan II and III, the INPEX Corporation and Rosneft have been consulting on oil exploration work. As for Far Eastern LNG projects, examination is being made, centered on Rosneft, for creating an LNG base of approximately 5 million tonnes annually and to export it, and Japanese trading firms and the government also have an interest and are supporting its substantiation. Concerning the expanded projects for Sakhalin II, Japanese firms are involved and are

pursuing their substantiation, with the further expanding of the liquefaction facilities. Furthermore, the Vladivostok LNG project has brought gas from Sakhalin and Eastern Siberia to Vladivostok by pipeline, and with Gazprom examining liquefaction there and its export, Japanese firms and the government are also supporting it, and consulting regularly thereupon.

Recently, there have been reports of a proposal for pipeline construction from the Russian side to the Japanese side, but such is not the truth. In addition, there have also been reports of the Vladivostok LNG project having been cancelled, but when I spoke to a person concerned at Gazprom, I received the answer that this is a continuing priority project.

However, when it comes to actually moving projects forward, there is also an area where today's sanctions will become a bottleneck. Additionally, energy prices over the last few months have slumped dramatically, and the assessment of how to proceed with large-scale LNG projects is becoming difficult. For large projects, whatever the period, it is necessary to clear a number of difficult matters, and proceeding from a long-term perspective is our stance.

Lastly, and incidentally here in Niigata, I would like to touch on the development of methane hydrates. Today, development of the methane hydrates in Japan's coastal waters is taking place, and the existence of considerable amounts of methane hydrates also on the Japan Sea coast, off Niigata Prefecture, is becoming clear. They also undoubtedly exist in Russia's coastal waters, and if there are requests for cooperation from the Russian side, we would like to respond proactively too.

[Translated by ERINA]

Keynote Address (Abridged)

Cooperation Projects with Japanese Companies in Russia's Far East

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Our company undertakes electricity generation in Russia's Far East. We are a RusHydro-affiliated firm, and together with that company we account for the electricity generation and distribution for one-third of the territory of Russia. The population of Russia's Far East is 6.2 million, and we account for 5% of the electricity demand for Russia as a whole, and 5.5% of the gross regional product. The total length of our grid is 100,000 km. Our company is the largest supplier of heat and electricity in the Far East.

We have made prospective plans for the electric-power industry in Russia's Far East, and have clarified the current situation and the challenges for the future. In the next ten years we will install new power facilities for thermal and hydropower, with a total capacity of 4.4 GW. This is equivalent to approximately half of the existing generation system. Moreover, we will replace aging networks and expand our thermal networks. We will also develop new additions to the thermal networks of at least 576 km. The total length of newly installed power lines will be 2,249 km. The development of renewable energy will be 120 MW. For Russia's Far East, 120 MW is a considerably large amount.

I will move on to the question of the drivers for Russia-Japan energy cooperation in Russia's Far East. The development of Russia's Far East is a national project of extremely high priority for the federal government. The federal government and all firms active in Russia's Far East are serious about the development and opening of the entire Far East. Regarding the current situation, the foundations have already been established to permit the implementation of Russia-Japan cooperation projects. The Russian Duma has already approved the establishing domestically of Areas of Advanced Development. The formation of 14 special zones is planned, and special preferential conditions are to be ensured in the legal, economic and fiscal spheres. All these take primary aim at the development of the Far East in its entirety. The strength of Japanese firms is the influence and knowledge which our partners possess. That is: high-tech equipment, and technology. I would like that to be put into operation in the Far East. Additionally, the setting-up of new companies is possible. I hope for the proactive participation of Japanese firms, which have experience in manufacturing high-efficiency equipment, and a high degree of competency.

"Crisis" is often talked about, but that doesn't only have a negative side. That is to say, there is the potential for projects to be implemented whose realization, in past circumstances, would not have been thinkable. We and US

and EU firms have been partners for many years. Today's new circumstances have offered new conditions, not only to Russia, but also to Western firms. For Western firms which say they want to be in the market in the future also there has not been a single instance of a project with the Russian side being cancelled. And next, it is considered necessary to conclude new agreements in the future. Respecting strategic interests in the future to the utmost extent is becoming today's direction for Western firms. Also Japan is the sole non-European country which has participated in economic sanctions against Russia. Of course, Japan's sanctions against Russia have been what you might call the "light" version. Chinese and ROK firms have been very proactive. We receive new cooperation proposals on a weekly basis from Chinese and ROK firms. Nonetheless, we are convinced even today that cooperation with Japan is strategically important. Consequently, we would like once again to express our gratitude to all of our Japanese partners. This is because, even though sanctions have been put in place, among our partner firms, the companies which have rejected us or cancelled have been zero.

I will introduce the projects which this company and our partners have already moved to implementation. These are: the energy bridge (power transmission lines); the production of liquefied hydrogen; the installation of cogeneration technology in Russia's Far East; and the development of renewable energy.

I would like to talk in more detail on each of these, respectively. There is a major project called the "Asia Super Ring". This is a massive project, with an appropriately long history, and is being eyed for the next 10-20 years. It can be divided into several parts, and among them is the construction of the energy bridge to Japan. In Japan the direction for nuclear power generation is being mulled. A supplement for nuclear power generation is the import of electricity from Russia. There was great agreement to the idea that energy dialogue should not be limited to moving hydrocarbons from one place on the globe to another. I too think that such a sector will rapidly continue to expand in the future.

Regarding the energy bridge to Japan, we are currently also putting great effort into electricity generation on Sakhalin, and are moving a number of projects to implementation. In a short while, the shortage of electricity on Sakhalin will be completely eliminated, and rather an excess in electricity only for supplying the Far East will arise. And a panel of experts has been set up by the Ministry of Energy of the Russian Federation, and it is

currently undertaking a feasibility study. At the end of this year the results of the feasibility study will come out, and we will report them to the Ministry of Energy. Taking the results into consideration, we will decide how to implement future projects. We are interested also in Japanese firms, financial institutions, and equipment manufacturers. In phases I and II of the energy bridge, we are to first link Sakhalin and Japan, and subsequently to link the Russian mainland and European Russia with Sakhalin. Regarding where to make landfall for the electricity transmission cables from Russia, while we are aware of the discussion also within Japan as to Hokkaido or Honshu, whichever is the place for landfall in Japan, we will deliver power after the infrastructure has been put in place.

Next, we will move toward implementation of a project for the industrial production of liquefied hydrogen in Russia's Far East together with Kawasaki Heavy Industries of Japan. In Russia's Far East, and Magadan in particular, there is cheap hydroelectric power, and electricity is in surplus. We will produce liquefied hydrogen using this low-price electricity. Transportation of liquefied hydrogen is possible using the equipment of Kawasaki Heavy Industries. This is an extremely important topic, and presently we have completed a pre-feasibility study, and are now examining it. In the near future we will determine its subsequent direction. We would eagerly like you to use hydrogen produced in Russia's Far East for the Olympic flame for the 2020 Tokyo Olympics. It would make a very beautiful flame. Of course, it will greatly contribute also to the development of the automotive industry. We are convinced that demand will become great in the future too.

Together with Kawasaki Heavy Industries we are also tackling a cogeneration technology project. This is the proactive introduction of that company's cogeneration technology. The "Eastern Gas Program" in Russia's Far East is moving to implementation. There will be natural gas-fired power generation, in addition to coal-fired power generation and hydroelectricity. The realizable projects are rapidly increasing, designs are being made, the necessary agreements are under preparation, and there is the prospect of generation in Vladivostok and Artyom before the end of the year. An investment feasibility study and designs are to be completed in the summer of next year. Subsequently we will commence work, and are considering beginning operations in 2015 or 2016. The infrastructure aimed at the APEC Summit which was held in 2012 in Vladivostok, and

that put in place since then, has become the foundation of the Vladivostok agglomeration. As a result, genuine demand for electricity has arisen, and we are going ahead with a variety of projects using Kawasaki Heavy Industries' technology. With not even the slightest change in sanctions, I would again like to express my gratitude for a sentiment of "continuing to be active in the future also in Russia's Far East".

Renewable energy is of extremely profound interest. In Russia's Far East there is oil, coal and natural gas too. In addition to that, renewable energy sources (solar, wind, and geothermal) abound. As an example there is cooperation with Komaihaltec, Mitsui, and the New Energy and Industrial Technology Development Organization (NEDO). This is to create a wind-farm in Kamchatka. Via this, we will be able to transmit surplus energy to boilers. Stage I has already been completed, and Stages II and III are in the pipeline. I would like to express my thanks to the people at Komaihaltec for the putting into action of a series of prior promises. Generating electricity from wind in the village of Novikovo in Kamchatka, it is set to transmit electricity to the main part of Russia also. The technology utilized will in the future be manufactured in proper fashion on a commercial basis. The wind electricity generation commencing in Kamchatka will spill over to other regions in the future. It is set to be exploited in the Arctic Ocean coastal areas also in the future. From the Chinese side too, there has been a proposal to generate 30 GW in the Arctic, and supply it to China's Northeast.

The Arctic Ocean coastal areas are an extremely interesting sector, and there exist a number of potentialities. We are seeking the possibility of energy security for our own promising projects there. The challenges that we have already been tackling with Mitsui will probably be useful in advancing these. Then, we will go on working with our current partners in the future also. We will go on utilizing in the future the technology which we are currently utilizing. As technology that can be used at -60°C to -50°C and in gale force winds is currently being used, its ongoing extensive introduction is possible in the future also. We recognize the strategic issues and challenges, and we understand that these are all things for which we will expand upon our cooperation. I would like earnestly to request all of you to participate in our projects.

[Translated by ERINA]