

Keynote Addresses

Bilateral Cooperation: The Prospects for Japan-Russia Energy Cooperation

Japan-Russia relations in terms of the economic and energy aspects

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The Russian economy grew favorably from before or after 2000 to about 2008. One of the driving forces for the economic growth was mineral resources that had led exports in the midst of the mild rise of resource prices. The economic growth rate of Russia, however, slumped to a significant deficit due to the decline of energy prices in the latter half of last year and the later worldwide economic recession caused by the financial crisis. The crude oil price turned upward again around the end of last year and is gradually picking up. Although Russia faced a more significant drop than China and India among the BRICs in economic growth in 2009, the Russian economy is expected to return to positive growth in 2010. The unemployment rate has been on a downward trend since May and industrial production is also hitting bottom.

The financial status of Russia has remained in surplus for the past ten years and the external debt in the government sector has decreased gradually. On the other hand, the overseas capital flown into the private sector has been increasing. Under such circumstances, the financial crisis hit the world last year. It is forecasted, however, that Russia is unlikely to face financial crisis for the time being with the general external debt decreased slightly in 2009.

In terms of the Japan-Russian investment relations, the trade volume increased sharply in the 21st century. It increased by 40% in 2007 to 2008 but decreased significantly in 2009. In the medium-to-long term, however, I think that there is still much potential for increasing trade volume between Japan and Russia. In terms of trade items, while transportation equipment accounts for three quarters of exports from Japan to Russia, such resource items as crude oil, non-ferrous metal, and coal account for more than a half of exports from Russia to Japan. In terms of imports from all over the world to Russia in recent years, while automobiles again account for approximately a half of imports, the import of other various items is increasing too such as chemicals, rubber, foods, and textile goods. Import items from Japan to Russia are expected to be expanded to various items instead of putting too much emphasis on automobiles like today.

The export of automobiles decreased significantly under the significant influence of the raised customs duties hike measures as a backdrop. It is a matter of great regret to Japan that Russia carried out such hike of customs duties while it is preparing for accession to the WTO. Hence, Japan is asking Russia to lift the customs duties at the

government level. Movements for import barriers including the hike of customs duties are also seen in items other than automobiles such as steel, liquid crystal televisions, plasma televisions, agricultural machines, and so forth, and Japan is asking Russia for improvement for such items too.

Even under such circumstances, the Russian market is expected to be expanded significantly, with major manufacturers branching out from abroad into Russia such as, in terms of automobiles for example, Toyota, Nissan, Mitsubishi, etc. from Japan, GM, Ford, and so forth. In addition, there are various companies branching out into Russia also in terms of other items such as tires, televisions, beer, cosmetics, and pharmaceuticals.

Complaints felt by Japanese companies, which have branched out into Russia, include the delay in the construction of physical distribution infrastructure such as ports and railroads, the uncertainty in industrial measures expected to be taken by the Russian government, and the complex administrative procedures. Joint efforts have been made between Japan and Russia with discussion held at various levels on the improvement of such business environment.

Eastern Siberia and the Russian Far East is relatively undeveloped for infrastructure. On the other hand, however, it is a promising region with abundant undeveloped resources. With a development program for Eastern Siberia and the Russian Far East adopted by the Russian government in 2007, Japan made a proposal called the "Initiative on the Strengthened Cooperation between Japan and Russia in Eastern Siberia and the Russian Far East" in response to it. In June of this year, a mission was dispatched to the Russian Far East region with the Ministry of Economy, Trade and Industry involved in the project along the direction of the initiative. The Japanese government intends to continuously promote the initiative in such a steady manner.

Russia is a resource-rich nation with more than 10% of crude oil production and more than 20% of natural gas production on a global basis. Japan imports crude oil from Russia only for several percent of the total imports. Japan imports natural gas mostly from the Middle East or Asian countries. Japan considers that it is extremely important for Japan to procure energy resources from all over the world to ensure energy security and that it is also very advantageous for Russia to cooperate with Japan for industrial development.

Sakhalin 1 started the export of crude oil in 2005 and approximately 40% of the total production is exported to Japan. Sakhalin 2 started producing crude oil in 1999 and started exporting LNG to Japan in March 2009. The LNG export project is a large-scale project with JBIC and NEXI involved.

In inland areas, crude oil is explored by a joint venture formed by a Russian oil company and JOGMEC and a pipeline is expected to be laid to as far as the Japan Sea according to the development status of oil wells. In addition, in the "eastern gasification program" by Gazprom, a pipeline is expected to be constructed toward the APEC in 2012 with companies participating from the Japanese side. And the cooperation is advancing between the Agency for Natural Resources and Energy, Gazprom, and Rosneft, respectively. The Japanese side is interested in securing resources and the Russian side also aims to develop the chemical industry by use of its resources under a framework intended to promote the partnership in a manner advantageous to both parties.

The Japan-Russia partnership has advanced also in the

sector of nuclear power that may be inevitable partly from the environmental perspective. The advantage of Russia in nuclear power lies in its possession of the world's largest uranium enrichment capacity. Mutually complementary cooperation has advanced between the two nations with technical cooperation provided by Japan and contributed from Japan and enrichment provided by Russia. The Japan-Russia Nuclear Cooperation Agreement was signed by Prime Minister Putin in May 2009 during his visit to Japan. Although it may take a little more time before the agreement takes effect, I hope that the agreement will be prepared smoothly.

We hope that the Japan-Russia partnership will be promoted in good combination between the resource aspect and the industrial aspect. Given that various daily necessities imported from Japan are spread in the Russian Far East region, we believe that the foundation for future industrial cooperation and resource cooperation will be formed by deepening understanding through the exchange of opinions not only at the government level, but also at the corporate level, the autonomy level, and so forth.

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Future prospect of the Japan-Russia Partnership

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I would like to discuss the prospect of the Japan-Russia partnership with the Asia-Pacific region as a keyword.

There are two documents that are extremely important in discussing the present Japan-Russia relations. One is the "Japan-Russia Action Plan" that was adopted on the occasion of the meeting of then Prime Minister Koizumi with president Mr. Putin during his visit to Russia in 2003. This action plan consists of the following six mainstays: the strengthening of political dialogue, the peace treaty negotiation, the cooperation on the international arena, the cooperation in the trade economy, the strengthening of relations in the defense and public security sector, and the promotion of international cultural exchanges. Energy is put into the development of Japan-Russia relations in line with the action plan.

The other document is the "Russian Far East/East Siberia Cooperation Initiative" that was proposed by then Japanese Prime Minister Abe to President Putin on the occasion of the Heiligendamm Summit in June 2007. Russia has recently started showing its intention to strengthen organic relations with the Asia-Pacific region. This document expects the constructive role assumed by Russia in the Asia-Pacific region and was explicitly supported by then Russian President Mr. Putin. We proposed that Russia should consider or support mutually-beneficial inter-governmental/nongovernmental cooperation chiefly in eight sectors; namely energy, transportation, information

communications, environment, security, health and medical treatment, trade investment, and interregional exchange.

Russia did not start branching out eastward over the Ural Mountains until the end of the 16th century. It was not before the middle of the 19th century that the Russian residential district emerged. Russians on the east side of the Ural Mountains have lived looking to the west.

In recent years, however, Russia has come to show an intention to enhance its own presence in the Asia-Pacific region. With the decision to hold the APEC Summit at Vladivostok in 2012, Russia shows the intention to participate in various international organs and frameworks in Asia. We welcome such intention aiming at an organic integration with the Asia-Pacific region.

Although Russians basically looked to Europe, Japan was one of the nations that had drawn the attention of Russia since an early phase. The world's first Japanese language school was established at Petersburg in 1705 by the order of Peter the Great. Peter might have considered that cooperation with neighboring nations in the region would always become necessary to manage the immense region far eastward from Moscow. Such expectation of Russia about Japan seems to actually remain the same today some 300 years later.

In addition, the Russian people have been highly interested in Japan since olden times from the cultural perspective too. The first overseas performance in the

history of Japanese kabuki was held at Leningrad, Moscow, in 1928. In terms of the contemporary literature, numerous translations of Japanese literature written by such authors as Haruki Murakami and Banana Yoshimoto are sold at book stores. Japanese people are, needless to say, highly interested in Russian culture. The mutual respect for and high appreciation of such culture of each other's nation by the people may form an extremely important basis for developing bilateral relations.

What Russia expects of Japan today may be scientific and technological capabilities. It is reported that although Russia is an energy rich nation, natural gas is consumed domestically by approximately two thirds. With the energy production itself peaked out too, the mining area is expected to be shifted from West Siberia to East Siberia in future. Japan is likely to become a potent partner on the aspect of such development technology too.

Specific cooperation projects under way in the resources and energy sector include the joint oil exploration project that has been implemented by JOGMEC with Irkutsk Oil Company in Irkutsk oblast of Russia since April 2008. If the exploration project identifies sufficient reserves, the construction of the East Siberia Pacific Ocean Pipeline along the Pacific coast will be promoted.

With the rights and interests of Sakhalin 2 held by

Mitsui and Mitsubishi at 22.5%, the plant and facilities for natural gas were constructed by Chiyoda Corporation and Toyo Engineering Corporation, the plant control system was manufactured by Yokogawa Electric Corporation, and a part of the liquefied gas transportation vessel was manufactured by Mitsubishi Heavy Industry. This is the first liquefied natural gas project for Russia. The liquefaction of gas is expected to enable Russia to branch out into spot markets and to take an advantageous position in price negotiation too. It will be significantly advantageous for Japan in terms of diversification of the import source. Approximately 7.3% of the annual imports of natural gas to Japan are from Sakhalin.

It is well known that Japan has the world's leading technology also regarding the energy saving environment. Although no large-scale partnership has been realized yet in this sector, negotiation is under way on, for example, the establishment of a joint venture for reduction of greenhouse gases based on the Kyoto Mechanisms.

Thus, we consider it very important to build up partnership in a manner mutually gainful both for Russia and Japan. The progress in such cooperation will further promote the integration of Russia into the Asia-Pacific region and will bring about interests to both nations.

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Energy strategy of Russia toward Japan and the Asia-Pacific region

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With regard to the measures that should be taken by Russia toward the strengthening of the Japan-Russia partnership in the energy sector, Russia should, first of all, improve the transparency of the Russian system for the market entry of foreign companies into the fuel energy sector with the laws concerning foreign investment and underground resources reappraised. Secondly, the Russian government needs to approve the "Russian Energy Strategy toward 2030 (ES2030)" that will serve as a key point for the stable development of the fuel energy sector. Thirdly, Russian energy companies should use a mechanism where they mutually make an equity investment in a foreign partner. This concept permits a foreign partner to participate in resource development in exchange for participation in the hydrocarbon processing sector or the energy distribution sector.

ES2030 is a new energy strategy of Russia. This strategy prioritizes the export of fuel energy resources to the Asia-pacific region at a ratio of 22% to 25% of oil and 19% to 20% of natural gas. The eastern vector will be realized by new resource development and infrastructure development in the Russian Far East/East Siberia without exerting influence on the cooperation of Russia with

European nations.

The output of crude oil in East Siberia/Russian Far East is estimated to become 100 to 105 million tons, the output of natural gas is estimated to become 130 to 150 billion cubic meters, and the output of coal is estimated to increase rapidly at 100 to 115 million tons by 2030. With infrastructure required to be developed first of all in order to realize the target, the construction of the East Siberia Pacific Ocean Pipeline, the eastern gas program, and small transportation projects are under way. In addition, export duties on oil mined from Siberia will be exempted and the natural resources mining tax will be exempted too at the initial stage of the production area development.

Russia uses various bilateral/multilateral cooperation programs in order to strengthen the partnership with neighbor countries in this region. Such cooperation programs include, for example, the intergovernmental agreement with Japan that is a guideline for long-term cooperation in the energy sector. The cooperation is expected to be made in a wide range including the exploration/production/transportation/processing, power generation, energy efficiency improvement/energy saving, and environment protection. In addition, cooperation is

active on the enterprise level too, such as the agreement concluded between Gazprom and the Agency for Natural Resources and Energy and between Rosneft and it, and the partnership between Atomenergoprom and Toshiba in the nuclear sector.

In the Sakhalin 1 Project, oil for export is shipped from De kastro. Russia can directly obtain revenue of 50 billion dollars from production-sharing. In Sakhalin 2, an epoch-making event, namely the LNG Production Plant Opening Ceremony was held on February 18, 2009 at Prigorodnoe. The estimated LNG production is 9.6 million tons per annum, of which the import to Japan is expected to reach 6% of the entire natural gas.

The first phase of the construction of the East Siberia Pacific Ocean pipeline is expected to be completed by the end of 2009 and the length has reached 2,700 km. In April 2008, an agreement was concluded between China and Transneft on the construction of the branch extending from East Siberia to the national boundary with China, crude oil trading, and financing. The pipeline extending from the national boundary with China to the interior of China is expected to be constructed by the China side. In addition, the development of Port Kozmino has started to improve the export efficiency. The situation about the refinery to be constructed at the end of the pipeline will be reported separately.

With regard to the Eastern Gas Program, I was directly involved in the negotiation with the government two years ago under the approval of the government. I am very glad that the program has shifted from the exploration stage to the project implementation stage. The Sakhalin-Khabarovsk-Vladivostok gas pipeline, for which

construction has already started, is firstly intended to meet the domestic demand, and secondly to export natural gas for the Asia-Pacific region, for the time being to Korea and China. A feasibility study on the liquefaction of natural gas has already started in Vladivostok, with an eye on the development of the gas chemical industry and on the future application of natural gas to be exported.

Recent Japan-Russia cooperation projects include, first of all, the oil well exploration/development by Irkutsk Oil Company and JOGMEC for which a test boring started on June 3, 2009. RusHydro is proceeding with negotiations on the construction of the hydraulic power plant in Nizhny Bureiskaya and the wind power electric power station in the Russian Far East, in which Mitsui and J Power are expected to get involved on the technical and financial aspects. The coal supply by Mechel and SUEK will be reported later. Bilateral cooperation is under way in the nuclear sector too. This cooperation intends to cover 25% of the Japanese demand for uranium from Russia through the re-enrichment of recovered uranium and so forth and the project cost is estimated to be 500 million dollars in ten years.

Energy security means the security both on demand and supply and should not be biased toward either of them. Arbitrarily fluctuating the forecasted demand/supply of energy will confuse producers and result in imbalance in the market. The forecast of gas demand in the Asia-Pacific region significantly varies among the information sources such as IEA and EIA sometimes with an error in excess of 30%. The demand needs to be forecasted definitely and specifically. In order to avoid such negative trends, it is important to harmonize multilateral, inter-regional, and inter-enterprise relations.

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Japan-Russia energy cooperation and regional energy security

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Why is the Japan-Russian energy cooperation important and actively discussed with much attention attracted? That is because the Japan-Russian energy cooperation has significant potential and importance in that it will mutually complement the energy supply security and the energy demand security between the two nations.

In order to scrutinize this issue, it is important to discuss it based on today's actual international energy conditions. The first actual condition is the increasingly important energy security issue and the climate change issue, in which Asia is expected to become extremely important. The second actual condition is the global financial crisis. The third actual condition is new trends of politics and economics in Japan, Russia, and in this entire region. The fourth actual condition is various prospects toward the regional cooperation through APEC and so

forth.

Let's look at the entire world situation in light of those conditions. First of all, the crude oil price sharply fluctuates in the international energy market. The crude oil price sharply fluctuated, after having risen to nearly 150 dollars in 2008, to less than 30 dollars in the beginning of 2009 and today to nearly 80 dollars. On the other hand, the energy demand will increase mostly in Asia, resulting in various influences on energy security issues in the world. Such agenda or restrictions as resource nationalism, investment, and energy transportation stability emerge on the supply side too. And the issues that are most important and are drawing the largest public attention in the world are sustainability and environmental issues.

Here, I would like to outline the global energy demand/supply prospect that was reported quite recently by

our institute. The global energy demand will increase in the medium-to-long term with the financial crisis overcome. The oil demand will significantly increase from 8.5 million barrel/day (2007) to 113 million barrel/day in 2035. Nearly 70% of the increment will be generated in Asia as a result of a significant increase of oil demand in developing Asian countries such as China and India. The position of Japan as the largest oil-importer in Asia will be replaced by China before long. India will become a large importer too. Asia's dependence on imports for oil is forecasted to increase steadily to 67% in 2007 and to 84% in 2035.

The demand for natural gas, which attracts attention as a clean fuel, is expected to increase more significantly than oil at 2 billion oil equivalent tons from 2007 to 2035, with Asia again here representing 40% of the demand. Such countries as China, India, and Japan are expected to become important natural gas consumer countries.

CO₂ emissions will increase naturally with demand. It is apparent that large coal consumer countries such as China and India will become future chief sources of CO₂ emissions.

A supply side country expected to become important in future is Russia. Russia has extremely abundant energy potential to supply including oil, gas, coal, renewable energy, and nuclear power. It is no doubt that Russia has potential large enough to meet the world's increasing energy demand.

The recent oil and gas production of Russia has slightly stagnated. Partly due to the influence of the financial crisis, the production at oil wells and gas fields in West Siberia, which have been the main force so far, remains sluggish. In order to expand the supply with the resources potential put into full use, it is important to increase the production in new or frontier areas. Future forecasts vary significantly among US EIA, IEA, and so forth and are uncertain. Such difference is attributable to the difference in views on how the development will advance and is not likely to pose any resource issues.

In terms of gas, although the production may increase in general, the production in the current major production areas will lower gradually. On the other hand, the gas production in the whole of Russia will expand by the progress in the development of new areas such as the Russian Far East region, Yamal, and Shtokman.

In light of such points, I would like to discuss how important the cooperation is for the energy consumption country Japan and the energy production country Russia.

One of the major characteristics of Japan is that it is an important importer and consumer of energy. Although Japan is inferior in growth potential to China or India, it is no doubt a stable and reliable market. The energy security and climate change issues amidst the high dependence on imports from the Middle East for oil, which have been the largest matter of policy, will be further emphasized more and more under the new administration. Further diversification/advancement of the energy supply structure will be pursued and cooperation with Asia including the vision of the Asian Community will likely be emphasized. In pursuing those agenda, it is important how to use the technologies, expertise, and know-how that have been accumulated since the oil crisis in the 1970s.

Russia is an important energy resource-rich country that can meet the demand expansion by making the most of its characteristic proximity to the growing Asian market characteristics. The financial crisis exerted various effects on Russia too and badly affected the European market. This means that the export market will become increasingly diversified. In addition, sustainable economic growth and diversification/advancement of the economic structure will be required in the energy strategy, and the promotion of the cooperation/integration of the entire region including APEC's energy cooperation will become important from a long-term standpoint as well.

From such a standpoint, there are various sectors with room for cooperation. One sector may be the complementarity between energy supply security and demand security. Other sectors include the expansion of the energy supply capacity in various regions including Sakhalin and the Russian Far East; the promotion of energy saving/alternative energy development by properly combining the characteristics of Japan and the needs on the Russian side; and the environmental cooperation. Such dialogue to promote the mutual confidence and information sharing as was held recently will become increasingly important partly to support such concrete energy cooperation.

Russia has an important role in filling the gap between the demand and supply of energy likely to expand from now on as an energy producing country. It is important for Japan and Russia to promote mutual cooperation so that both may obtain benefits while facing the new political/economic/energy market environments and to develop such a method that will spread the benefit to the entire region and the entire world.