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Power and Resources

New Energy Partnerships and a Boost for Decarbonisation?

The War in Ukraine and Its Repercussions for Energy Policy in Asia

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The Russian attack on Ukraine has led to turbulence on the Asian energy markets. The consequences are manifold: on the one hand, the rise in the price of fossil fuels may well provide decarbonisation with new momentum in many Asian countries. On the other hand, states such as India and especially China might try to cheaply purchase Russian energy resources, which are being increasingly shunned in the West. Thus Moscow, subject as it is to sanctions, has new opportunities for energy cooperation – but risks becoming increasingly dependent.

On the energy markets, a state of emergency has become the new normal. Over the last two years of pandemic alone, energy supply infrastructures faced price collapses and then later, as economies recovered, price spikes. The high energy prices are thus having a noticeably dampening effect on global economic development. Added to this are bottlenecks in raw materials in such areas as critical minerals for renewable energy technologies, the semiconductor industry, and the chemical industry, resulting in interrupted supply chains and restricted production on a global scale. The Russian attack on Ukraine has exacerbated these developments and could lead to a fundamental reorganisation of global energy security structures, one that will also, and perhaps especially, become apparent in Asia.

In record time, the Russia-Ukraine conflict threw aside the firmly rooted certainty of reliable gas supplies from Russia to Europe, a certainty that had remained unshaken even during the Cold War. What is astonishing is that the energy policy decoupling between Europe and other Western democracies on the one hand and Russia on the other now seems to be intentionally sought by both sides. For Europe, despite plans to switch to renewable energy sources as part of its decarbonisation by 2050 in any case, this is a daring step. In the short term, Europe is dependent on imports of Russian gas, oil, coal, and minerals critical to decarbonisation technologies, and thus it risks power outages. Nevertheless, given the security policy dimension of the war, it is increasingly willing to pay a high price for energy independence from Russia. In retrospect, the extent to which Russia anticipated this development is difficult to determine. However, for years Russia has worked intensively to expand energy relationships in Asia, most notably with China.

The Asia and Pacific region is home to important energy consumers such as China, India, Japan, and South Korea, whose energy demands have a global impact. Russia's eastward orientation is therefore not surprising. Whether Asia can actually serve as a substitute energy export market remains to be seen, given the historically unprecedented Western reaction that has made Russia the most heavily sanctioned country in the world in a very short time.

Asian Energy Markets

The war between Ukraine and Russia has both a direct and indirect impact on energy security in the Asia and Pacific region. An important direct effect concerns energy relationships between Russia and Asia. Almost half of Russian oil exports went to Europe in 2021, with slightly less than 40 per cent going to Asia.[1] Just under 75 per cent of Russian gas exports went to Europe and only 13 per cent to Asia.[2] On the other hand, more than 50 per cent of Russian coal exports went to Asia and just below 30 per cent to Europe.[3] The US energy sanctions, which are isolating Russia economically and politically on global energy markets in the short term, will

have little effect on these energy deals. The primary Asian importer of oil, coal, and gas from Russia is China, which has made it clear that it will not limit its trade with Moscow to support Western sanctions.[4]

The indirect energy market effects of the war in Europe are already demonstrating their disruptive potential in Asia.

Japan, South Korea, and Vietnam also import significant amounts of Russian liquefied natural gas (LNG), coal, and oil, but to a much lesser extent than China. Japan, too, is a direct partial owner of LNG and oil production facilities in the Russian part of the eastern Pacific. Japan supports a decision by the G7 countries to ban or phase out oil imports from Russia. However, Japan, which is highly dependent on energy imports, will not abandon oil imports from Russia quickly for energy security reasons.

The indirect energy market effects of the war in Europe are already demonstrating their disruptive potential in Asia. European governments and corporations are driving up the already high prices for coal, oil, and gas with their demand for alternatives to energy imports from Russia. For Asia, which is an overall net energy import region, this engenders a rise in local energy prices, which, in turn, means inflation of national currencies in many countries in the Asia and Pacific region.[5] Fiscal countermeasures taken by many governments are likely to increase debt in the region, weakening overall economic growth in the long term.[6]

Yet there are exceptions to this trend in the Asia and Pacific region: Malaysia, Indonesia, and Australia are net energy exporters and will benefit from increased demand for energy raw materials, at least from an overall economic standpoint.[7] Malaysia is the second-largest producer of oil in Southeast Asia and the fifth-largest LNG exporter in the world. The country's geographical location is also ideal for global trade, since the Strait of Malacca is a central bottleneck for international trade in raw materials. Indonesia is the world's largest coal exporter and also exports LNG. The two Southeast Asian countries expect significant additional revenues from rising global energy prices. On the other hand, they are granting extensive energy subsidies to keep domestic energy prices low for end users in industry, but also for households. Some of the additional revenues will therefore be used for the increased energy subsidy costs. Indonesia imports a large part of its oil and is therefore negatively impacted by the high oil prices. It also imposes strict coal export regulations to protect domestic energy supply. In January 2022, this even led to a short-term discontinuation of exports. Overall, however, Malaysia and Indonesia will manage the economic risks relatively well.

Australia is currently generating additional revenue from raw materials exports. Even during the energy shortage late last year in the course of economic recovery from the pandemic, Australia profited from rising coal and LNG prices in Asia. Now it is also European energy companies that are not only looking to purchase Australian energy resources in the short term, but also to sign long-term contracts. EON, a German energy company, also plans to import Australian green hydrogen.[8]

The gas market in Asia has been especially affected by the war in Ukraine.[9] LNG prices are being driven up by demand from Europe, which is desperately seeking alternatives to imports from Russia. For Asian LNG importers, especially in South and Southeast Asia, this poses a challenge because, unlike Japan and South Korea, they cannot bid in these high price categories without incurring extensive debt. Bangladesh is one of the worst affected.[10] In many Asian countries, gas is regarded a secure interim energy that would lower CO_2 emissions in the medium to long term while covering growing energy demand. Investments planned and already implemented in the gas sector are therefore very high. In Indonesia, the Philippines,

Vietnam, South Korea, and Japan, plans for expanding gas usage capacities already exceed the shutdown rate for coal-fired power plants.[11]

The largest investments in gas infrastructure are currently being made by China, the only Asian country with a gas pipeline to Russia and long-term delivery contracts to protect it from an overheated Asian LNG market. China can also import Russian LNG by sea. However, difficulties will arise for the Southeast Asian countries, especially Vietnam, Thailand, and Myanmar, which have made significant investments in domestic gas-fired power plants and LNG terminals. These investments are coming under scrutiny due to the persistently high LNG prices. The consequences for these and other countries could be high risks to energy security.

New Energy Partnerships: Russia-India

India shows how disruptive indirect energy market effects in Asia are in the short term, but also how they can lead to direct changes in regional energy supply relationships in the medium to long term. As Asia's second-largest oil importer (after China), importing over 80 per cent of its oil, India is particularly at risk from high energy prices.[12] Subsidy regimes to secure energy price corridors are only rudimentary and will therefore have a limited mitigating effect on rising prices,[13] which are passed on more or less directly to end users in industry and to private households. The Indian government is therefore considering expanding its oil, coal, and LNG imports from Russia, which have so far accounted for less than five per cent of overall energy imports.[14] Indian energy companies may thus participate in Russian energy projects. In view of Western sanctions, the deal is to be transacted through a rouble-rupee payment system set up specially to this end.[15]

Cheap Russian oil is an attractive opportunity for India, since it is being offered at a heavily discounted price.[16] And India cannot be accused of inconsistent policy. It can look back on a long partnership with Russia. India can also counter critics with the valid argument that Europe continues to import Russian energy resources as well.

India could become more dependent on Russian energy resources.

Instead, India's challenges in expanding energy trade relationships with Russia lie in Indian refineries having to adjust to Russian oil quality, which differs from Middle Eastern quality. Trade logistics could also be complicated. Thanks to the rouble-rupee payment system, US sanctions on Russian oil would not affect the financial part of the deal, but logistics companies would be exposed to a certain reputational risk that could have a practical impact in the form of high insurance premiums for shipping. What is more, previous oil suppliers in the Middle East or coal exporters such as Australia and Indonesia could quickly, and maybe permanently, align themselves with other consumers such as Japan and/or South Korea. This could jeopardise India's long-established energy relationships and increase dependency on Russian energy resources.

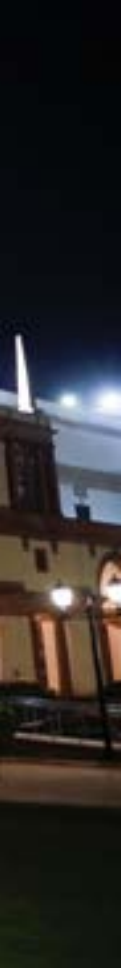
Russian-Chinese Energy Partnership

The close energy partnership between Russia and China is not only logical due to the current political situation. Russia has a large supply of fossil fuels such as oil, coal, and gas, but also of aluminium and critical minerals like nickel, which are needed for renewable energy technologies among other things. China, on the other hand, has become a global market power. It produces a range of goods for the world market and requires energy and raw materials to do so. At the same time, the two countries enjoy close geographical proximity in the form of a long common border. From an energy perspective, this gives rise to advantages for both sides.

A welcome opportunity: While Western states are increasingly replacing Russian energy sources, India could buy them from Moscow at bargain prices in future. Source: © Adnan Abidi, Reuters.

Russia is currently China's second-largest oil supplier after Saudi Arabia, the second-largest coal supplier after Indonesia, and the third-largest gas supplier (pipeline and LNG imports combined) after Turkmenistan and Australia.[17] China, on the other hand, has shares in Russian LNG terminals and joint pipelines. Energy industry circles believe that the further involvement of Chinese energy companies in Russian energy supply companies is entirely plausible. Russia is thus a fixed part of China's energy partner portfolio. But this has not yet resulted in China's unilateral dependence on Russia. China is focused on a broad mix of energy imports from a wide variety of countries worldwide. The lion's share of Chinese energy imports does not come from Russia. On the other hand, China is Russia's most important energy export market in Asia.

The energy relationship between the two countries has intensified primarily over the last few years – not least in the run-up to and aftermath of Russia's occupation of Crimea. Since 2019, the Power of Siberia Pipeline 1 (POS 1) has been supplying gas directly from Russia to China. Cooperation on POS 1 and Chinese investment in the Russian Yamal LNG and Arctic LNG 2 terminals were both realised immediately after the Crimean crisis. During the Winter Olympic Games in Beijing, China and Russia announced further energy agreements. For instance, gas exports from Russia to China are to be increased. The gas is to flow from gas fields off the Russian Pacific Island of Sakhalin and go to North China. POS 1 could be connected to the corresponding Pacific pipeline (Sakhalin-Khabarovsk-Vladivostok).[18] Also during the Olympic Games, an oil agreement was renewed



in which Russian oil is exported to China via an existing pipeline through Kazakhstan. This pipeline complements Russia's Eastern Siberia-Pacific Ocean pipeline. Russian-Chinese energy relations could also be further intensified in future by the Power of Siberia 2 (POS 2), which is to run through Mongolia, where it is called the Soyuz Vostok pipeline, and which should even be able to access gas originally intended to supply Europe.

Especially with a view to the pipeline and LNG terminals, expanding energy relations to Russia is an attractive deal for China. China has ambitious climate goals and despite having expanded its coal-fired power plants and reactivated coal mines during the energy crisis in late 2021, it wants to reduce coal in its energy mix in future. Gas will play an important role here. The long-term pipeline connections to Russia represent stability, especially compared with the volatile LNG prices on the world market, which are being driven up further by European demand for gas. China can thus decouple itself from the highly competitive global LNG market. The close energy partnership also improves China's energy security.

The first Chinese companies appear to be reserved when it comes to purchasing Russian oil.

The intensified energy dealings with Russia do pose risks for China, however. While these deals allow China to acquire important energy sources cheaply over the long term, US sanctions could become a problem especially for Chinese energy companies operating internationally. The exclusion of Russian banks from SWIFT is only a minor problem between Russia and China from an energy standpoint. The Chinese alternative, the Cross-Border Interbank Payments System (CIPS), could be used as a substitute if payment transactions were made in yuan. Yet things will become difficult if the US actually imposes downstream sanctions. This could lock internationally active Chinese energy companies out of international markets or banks. And the first Chinese companies do indeed appear to be reserved when it comes to purchasing Russian oil.[19] It remains to be seen whether Chinese energy companies are able to find ways of legally circumventing the sanctions.

Energy Policy and Decarbonisation

From an energy policy perspective, the war between Russia and Ukraine appears to be accelerating a long-term trend: global suppliers of fossil energies from Africa, the Middle East, and Latin America are focusing on Asia because that is where a greater demand for oil, coal, and gas currently prevails and will do in future in any case. Russia's orientation towards the Asian energy market can therefore be seen as strategically consistent from a purely economic standpoint and with a view to the EU's climate goals. Russia's energy relations with China are of fundamental importance here. It is not only about the Chinese energy market, the largest in Asia, but also about access to the Asian market overall.

For Russia, however, this step could be associated with what is expected to be an almost complete economic and political decoupling from Europe and other Western democracies. Russia's plan of, where necessary, offering its fossil energy sources in Asia and Europe at the same time and strategically exploiting this situation, will thus probably be unsuccessful in the medium term. The consequence of sanctions is a greatly weakened Russia that finds itself increasingly economically dependent on China. Russia must accept that transacting its trade, which is still mostly in dollars, will not strengthen the rouble, but rather the Chinese yuan. Russia's announcement that it will do energy deals with "unfriendly states" only in roubles in future, can probably be interpreted as a reaction to this realisation. On the other hand, oil, coal, and gas are not all Russia has to offer. Also in its possession are critical minerals such as nickel that are essential for building batteries

for electric cars. The prices for these minerals have also risen dramatically. Given the current situation, Europe will also have to replace these raw material imports from Russia if it wants to reach its climate goals. But it will be in competition with China, which needs these raw materials, too.

The expansion of energy relations between India, a US ally in the Indo-Pacific, and Russia could have a fundamental signalling effect on energy security throughout the entire region. Here, it is not just a matter of competing systems in global politics, but also regional spheres of influence. India is the second-largest energy importer in Asia (after China). The question now is whether, given the high prices on the world market, other Asian countries will take advantage of relatively cheap Russian energy resources and thus undermine US sanctions. It

cannot be excluded that South and Southeast Asian countries currently affected by high LNG prices will turn to Russia for LNG. After all, European countries continue to purchase Russian energy resources, too.

For Russia, the expansion of energy relations to Asia is not without risk. China, its established energy partner, and India, its possible new partner, are regional competitors, and Russian-Pakistani energy relations could well have a negative effect on relations with India. On the other hand, it might be precisely that Russian-Pakistani connection that may prompt India to deepen trade relations with Russia. Furthermore, Russia has cultivated trade relations with a wide variety of countries in the region for decades, especially for arms exports; an even more sensitive issue from a geopolitical standpoint. Still, India will have to weigh up how to reconcile the perpetuation of a political counterweight to China in the region and the necessary cooperation with other Western democracies with its national energy security interests in the long term.

From Siberia to China: Since 2019, a pipeline has been transporting gas directly from Russia to China. In future, gas originally intended for Europe could also flow to Beijing via a proposed new route. Source: © Maxim Shemetov, Reuters.

China ist not only interested in improving its energy security, but also in pursuing its own climate goals.

Intensifying its energy relations with Russia enables China to improve its energy security. It is acquiring expanded, permanent access to Russian energy resources and infrastructure. But China is not only interested in improving its energy security, but also in pursuing its own climate goals (CO_2 emission peak by 2030 and CO_2 neutrality by 2060) with gas as an alternative to coal. This is where the expansion of its green technologies industry through domestic value chains, which has long had a global dimension, comes in. China has developed a profitable renewable energy technology industry benefiting from monopolies on critical minerals and rare earths in its domestic territory, as well as from Chinese state-owned extraction companies operating in numerous countries all over the world, including Indonesia and the

Philippines. It is even the global leader in solar panel production. With additional gas imports and the falling CO_2 emissions likely to follow from them, China would be much better positioned for the European Carbon Border Adjustment Mechanism, which could become a major problem for the CO_2-intensive Chinese export industry.

It is difficult to predict what overall effect the war in Europe will have on Asian decarbonisation. But a good assumption is that the enormous increase in fossil fuel prices will make renewable energies, which are already economically competitive, even more so. Many Asian countries will therefore intensify their entry into, or broad expansion of, renewable energies, and reduce expansion of interim energies such as gas. Nuclear power might also benefit. What is certain is that the war in Europe will have consequences for Asian energy security. New energy partnerships will influence major systemic disputes in Asia, and decarbonisation may ultimately be accelerated.

– translated from German –

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