



APEC ENERGY TRADE AND INVESTMENT ROUNDTABLE

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Current Challenges in APEC Natural Gas Trade

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The APEC Energy Trade and Investment Roundtable is aimed at fostering and augmenting energy, environmental, trade and investment policies to overcome trade and investment barriers in the energy sector. The APEC Gas Forum (APGAS) warmly supports this initiative.

The Role of APGAS

The idea of an APEC Gas Forum arose from the desire of APEC Energy Ministers to accelerate cross-border natural gas trade as a response to energy security concerns. According to the "Energy Security Initiative Fact Sheet", tabled at the meeting of APEC Energy Ministers in Darwin in June 2007:

"The APEC Gas Forum (APGAS) was established with the aim of creating a competitive, open and transparent marketplace for natural gas, particularly LNG, in the region. The two APGAS Forums to date, Perth 2005 and 2006, have provided a platform for high-level discourse between suppliers, consumers and transporters in both government and industry to discuss and debate issues that facilitate a vibrant regional trade in natural gas and LNG."

To this, I would add that, in an increasingly carbon-constrained global economy, the importance of accelerating cross-border natural gas trade continues to mount as every day passes.

APEC holds other energy forums – the APEC Energy Working Group (EWG) meets at 6-monthly intervals and APEC Energy Ministers usually meet every alternate year – but the agenda at those meetings is set by governments. APGAS is a unique public/private sector forum on energy security and climate change that is driven by the natural gas industry. It is also unique in that the public and private sector participants that gather under the APGAS banner represent some of the largest gas exporters in the world, and the largest importers.



A Dramatic Change in the LNG Supply/Demand Balance

Since the first APGAS Forum in 2005, the LNG supply/demand balance in the Asia Pacific region has changed dramatically. In this very short period, Middle East supply has come into increased prominence and the integration of the Atlantic Basin and the Asia-Pacific markets has continued to edge closer. Nonetheless, LNG demand has outstripped supply.

Energy Security

Energy security concerns remain a critical element on the APEC agenda. As mentioned above, the unique structure and drawing power of APGAS is accepted by APEC Energy Ministers and officials as having a key part to play in enhancing APEC's energy security policy framework.

Climate Change and the Role of Natural Gas in Transitioning to a Low-Carbon Global Economy

Concerns over climate change have been increasingly looming over the global economy with the result that climate change is now as important as energy security on the APEC agenda. More than half of greenhouse gas emissions are energy related. Exactly how the economies of the world will be able to constrain emissions, and how their responses might impact on energy trade, have become topics of great importance and great challenge.¹

As a comparatively clean, low-emissions fuel, natural gas provides one of the transitional solutions to the climate change problem through its capacity to reduce carbon intensity (the intensity of greenhouse gas emissions) in the stationary energy sector, mostly in power generation. Nevertheless, the issue of how carbon is to be priced is now inhibiting investment and creating a cloud of uncertainty over cross-border natural gas trade.

The Gas Exporting Countries Forum (GECF)

It should be emphasised that APGAS stands for something completely different from the GECF, although the membership of the GECF includes three APEC member economies: Russia, Malaysia and Indonesia. The 16 GECF members control 70% of global gas reserves. Their plan, announced in April 2007, to develop a common methodology on the formation of gas export prices appears to have come to nothing, despite claims at the time that a "Gas OPEC" was in the making.

¹ As Yvo de Boer, Executive Secretary of the UN Framework Convention on Climate Change said recently in his address to the Africa Carbon Forum in Dakar, Senegal on 3 September 2008:

"What the world needs is a global, low-emissions economic development plan that makes climate-friendly economic growth globally viable. Such a plan needs to ensure that especially developing countries are tied into it and benefit from its fruits. A quick look at anticipated energy investments clarifies how important this is.

The energy sector is responsible for by far the largest share of global CO2 emissions. According to the IEA, global energy demand will grow by 55% by 2030. In the period up to 2030, the energy supply infrastructure world-wide will require a total investment of \$22 trillion, with about half of that in developing countries. Meeting Africa's energy needs would require about \$1.5 trillion (1461 billion).

This means that we face the challenge of greening this massive investment sum by creating win-win opportunities for the money to be invested in low-emissions technologies, such as renewable energies. If we fail to achieve this, emissions will go up by 50% instead of down by 50%, as science says they should."



We should again remind ourselves that, since the time of its formation, the dynamism of APEC has been underpinned by a consistent commitment to open trade and investment. In their September 2007 Sydney Declaration, APEC Leaders reaffirmed:

“The pursuit of climate change and energy security policies must avoid introducing barriers to trade and investment. Open trade, investment and environmental policies are crucial to disseminating low emissions products, technologies and best practices.”

In charting the pathway to a future international climate change arrangement, APGAS commends APEC Leaders for sticking to their commitment to the 1994 Bogor goals of open trade and investment. Nonetheless, a significant risk remains that climate policies may detract from the effective operation of the international trade regime.

Issues of Current Concern to the Natural Gas Industry

At APGAS 2007 in San Diego, the main issues of current concern to the natural gas industry were identified and certain conclusions were reached. They are summarised in the attached table.

The following concerns are worth noting by the Roundtable:

The Key Concern of Customers

Today, the key concern of most LNG customers is reliable supply at a competitive price, rather than trade or regulatory barriers.

The Key Concerns of Developers

Today, the key concerns of most developers of new LNG production and import terminal capacity are the overheated construction market, the escalating capital costs that have accompanied it, the difficulties involved and time required to obtain project approvals and uncertainty about the cost of carbon and where the cost will be levied.

Public Trust in LNG Development

The LNG industry is also concerned about the ongoing task of maintaining public trust in LNG development. Public trust is necessary to avoid capricious and discriminatory political decisions that can inhibit the development and maintenance of a level playing field for the industry. Public trust is best maintained through cooperation between government and industry and by face-to-face contact and open dialogue amongst relevant government and industry players.

Barriers to Expansion of Natural Gas Trade: Barriers to Investment in New Capacity

The main barrier to natural gas trade is the **tyranny of distance** between sources of supply and centres of demand. Of course, this is a natural barrier that cannot be removed.

The barriers to **expansion** of natural gas trade are mainly the **barriers that impede investment** in new export and import capacity. These barriers to investment are mainly internal (so-called "behind the border") issues that are affected by the entire spectrum of domestic policies, not only energy policy. Apart from pointing to the issues and conclusions of APGAS 2007 set out in the table, there is no particular policy barrier that APGAS wishes to single out as requiring removal or review.



What APGAS would like to emphasise is that the question whether natural gas at the border will fulfil its destiny and become a more widely-traded fuel in the Asia-Pacific region depends almost entirely on investments being made in new capacity.

Good Policy Settings Remain Essential But What Are They?

It cannot be over-emphasised to governments that the huge capital costs and long time horizons of LNG investments do not automatically equate to high profitability. Investors remain as risk-aware as ever. Increasingly scarce availability of capital puts even greater emphasis on risk management by investors, and heightens political risk as a concern.

The main need is for good policy settings that encourage investment to take place. In addition, there must be certainty and consistency of application of these policies. There is no single policy setting that will have decisive effect. Good policy settings comprise the entire spectrum of policies that can have an impact on investment stability, ranging from fiscal terms to environmental requirements.

Uncertainty over Climate Policies

With the future of the post-2012 climate regime being very much up in the air pending the outcome of the UNFCCC meeting (COP 15) that is scheduled to take place in Copenhagen at the end of 2009, and with various domestic emissions trading schemes being proposed in Australia and elsewhere, APGAS believes that the level of uncertainty over future climate policies and regulations (and therefore costs) is actually increasing.

Uncertainty over climate policies has a dampening effect on investment and financing decisionmaking, and a negative effect on the industry's rate of growth. It is worth adding that cross-border issues are one of the greatest areas of uncertainty for governments and investors in the debate about constraining carbon, particularly between Annex B and non-Annex B countries.

The imposition of a carbon cost in one economy is likely to further dampen investment in that economy and distort the global playing field for affected industries that are trade-exposed. Nowhere is this more obvious than in the LNG sector.

Given the global nature of the climate change problem, the Roundtable might wish to consider the merits of a sector-specific approach to the reduction of emissions in the LNG sector.² This would provide an alternative pathway for economies that are not prepared to accept binding economy-wide emission reduction targets and could speed up the global response to climate change. Sectoral commitments are especially suited to industry sectors such as LNG and metal production that compete on global markets.

More broadly, there is a risk that the international climate regime may infringe on the international trade regime, despite the reaffirmation by APEC Leaders of their commitment to open trade.

² Richard Baron et al, "Sectoral Approaches to Greenhouse Gas Mitigation: Exploring Issues for Heavy Industry", IEA Information Paper, International Energy Agency, Paris, France, November 2007. Cooperative sectoral approaches to reducing emissions were discussed at the recent UNFCCC workshop in Accra, Ghana during the UNFCCC Working Group sessions on 21-27 August 2008.



Conclusion

APGAS considers that the risks and opportunities associated with the intersection of the international climate regime and the international trade regime, so far as they relate to APEC energy trade, require close examination, given the need for all economies to prepare for COP 15 in Copenhagen at the end of 2009.

In the meantime, there should be no doubt in anyone's mind that policies that favour the greater use of natural gas in a country's energy mix, and an increase in cross-border natural gas trade, can benefit the global climate by reducing growth in the aggregate level of greenhouse gas emissions.

The inescapable conclusion is that any domestic policy that inhibits natural gas investment is bad climate policy, and bad for energy security.

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TABLE : MAIN ISSUES IN APEC NATURAL GAS TRADE AND INVESTMENT IN 2007	
Issues Identified at APGAS 2007	Conclusions Reached at APGAS 2007
1. Global energy demand is continuing to expand , bringing heightened energy security concerns with it. Expansion of natural gas trade in the APEC region is now more widely recognized as one of the key responses to this expanding demand	The looming short and medium term shortage of LNG supply in the Asia-Pacific region is of particular and increasing concern to APEC energy importing economies. It is essential that investment in new LNG capacity be accelerated. Much greater policy priority should be given to facilitating this.
2. Expansion of LNG trade is almost entirely dependent on investments being made in production capacity, liquefaction capacity, shipping capacity, terminal capacity, re-gasification capacity and storage capacity	A prerequisite for expansion of trade is the need to provide a certain and secure investment environment for providers of capital to induce them to invest in new capacity.
3. Long-term "take or pay" contracts remain pivotal for upstream LNG investment , as they are for long-distance cross-border natural gas pipelines	Trade can be facilitated by: <ul style="list-style-type: none"> (i) partnership-building between investors and governments; (ii) relationship-building between suppliers and customers; and (iii) vertical integration, with suppliers moving downstream and customers moving upstream, which will blur the traditional distinction between sellers and buyers.
4. The current major challenges for LNG projects are rising costs and the shortage of skills and materials	There is a limit to what can be achieved to overcome this in the short term. There also are limits to the additional costs that can be passed through to customers. Some proposed projects might need to be put on hold or deferred.
5. Uncertain environmental standards are making risk management difficult and are acting as a dampener on investment	A universally-accepted way of pricing carbon is essential in order to create a level inter-fuel playing field. For investors, clear policies on GHG emissions are essential for them to be able to manage their risks. Carbon prices will need to be relatively high to induce significant shifts to natural gas-fired generation.
6. To reduce front-end risk and to accelerate development, investors need legal assurance at the earliest possible stage that their projects can go ahead subject to compliance with appropriate and ascertainable standards	There remains a need for further funding of APGAS-related activities, including: <ul style="list-style-type: none"> (i) development of best practices in market design and regulation and (ii) development of standards for many aspects of LNG trade-related activities.
7. Timeliness, reasonableness and consistency are essential features to be observed in the process of project approvals	There is a need for an APEC code of best practice to address the lack of timeliness of project approval processes.

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