

# An Asian Oil and Gas Union: Prospects and Problems

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Eurasia, herein defined as Northeast and Central Asia, has been ravaged by historical and current conflicts of both military and political nature, such as Japan or Russia's occupation of their neighbors, border disputes etc. This has created an environment where there is a chronic lack of trust among the regional actors and relations are often seen as a zero-sum game, or in relative gains. From an international perspective, it is symptomatic that there is very little cooperation in the military and political fields. For instance, Northeast Asia has no institutionalized regional organization that deals with political and military conflicts while trans-regional organizations that include cooperation between Northeast Asia and Central Asia states are far limited only to exercises against terrorism.<sup>1</sup> There have been several organizations initiated in Central Asia working on cooperation but their viability is limited. This is due to limited political support from the respective Central Asia governments and also because of the intra-regional rivalry between the five Central Asian states.<sup>2</sup> Thus, these organizations remain relatively weak and their future prospects uncertain. In order to have conflict management and resolution frameworks in place, and to establish greater trust between the different actors, these organizations would need to integrate deeper into the region, politically and economically.

The present situation has not passed without criticisms from the regional powers. For instance, China has repeatedly highlighted the need for more substantial areas of cooperation in the region especially in the field of

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<sup>1</sup> Swanström, Niklas L. P., "The Prospects for Multilateral Conflict Prevention and Regional Cooperation in Central Asia," *Central Asian Survey* 23, 1 (March, 2004); Swanström, Niklas L.P., "Regional Cooperation and Conflict Prevention," in Niklas L.P. Swanström (Ed), *Conflict Prevention and Conflict Management in Northeast Asia* (Uppsala & Washington: CACI & SRSP, 2005).

<sup>2</sup> Annette Bohr, "Regionalism in Central Asia: new geopolitics, old regional order," *International Affairs* 80, 3 (2004).

energy.<sup>3</sup> Japan has also similarly called for greater integration within Central Asia in cooperation with Japan.<sup>4</sup> Among the list of regional organizations present in Central Asia, a promising trans-regional organization is the Shanghai Cooperation Organization (SCO). The SCO is presently limited to Central Asia, China and Russia, but its attempt to promote multilateral cooperation is praiseworthy. Although it has only relatively modest accomplishments to speak of, outside of the successful resolution of the border disputes between China and the Central Asia states, cooperation carried out via this organization has thus far proven to be a success without parallel in Eurasia. However, it will be a long time before we are able to witness an institutionalized regional structure, like that of the European Union, which could act as a platform to mitigate the rivalry and distrust by entrenching interdependence between member states. As with the case of Europe, in order for greater regional integration to occur politically in Eurasia, focus has to be shifted to true economic integration in Eurasia. As economic ties grow, politicians have to coordinate their policies better and this will lead to further developments in the field of political cooperation and integration.

Today, China, Japan and Russia are competing for influence and market shares internationally and such rivalry is most intense in Central and Northeast Asia. The competition we are presently witnessing has been accentuated by a lack of trust between the different actors due to their age old military and political conflicts with one another. Meanwhile, the smaller actors in Eurasia, especially in Central Asia have their own agenda aimed at diluting the influence of the major actors in the region and preventing domination by specific actors, such as Russia in Central Asia.<sup>5</sup> This potentially explosive situation is compounded by the fact that the states in Northeast Asia are increasingly facing a perceived energy crisis due to increased competition over energy resources and high energy costs. A growing number of policy-makers are beginning to believe that an energy crisis or an intense struggle over resources is imminent. This sense of emergency is created by the lack of cooperative structures in the field of energy and because of the intense competitive behavior between the states seeking energy security, especially China and Japan. Within Eurasia, Russia and Central Asia have significant amounts of oil and gas they would like to export but they have been using their

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<sup>3</sup> Talgat Baimukhambetov, *Kazinform*, July 2 2005; David Kruger, "Prosperity Tied to Regional Cooperation" *ADB Review* (November, 2004); "Hu Jintao expounds China's stance on win-win cooperation" *Xinhua*, November 18, 2005.

<sup>4</sup> Address by Prime Minister Ryutaro Hashimoto to the Japan Association of Corporate Executives (Provisional Translation), Prime Minister of Japan and His Cabinet (Kantei), July 24 1997, <[www.kantei.go.jp/foreign/0731douyukai.html](http://www.kantei.go.jp/foreign/0731douyukai.html)> (October 30, 2005).

<sup>5</sup> Roy Allison, "Strategic reassertion in Russia's Central Asia policy," *International Affairs* (vol. 89, no. 2, 2004).

resources as political leverage which in turn contributes to zero-sum thinking among energy-hungry China and Japan. For Northeast Asia, the failure to integrate and cooperate on energy issues have thus resulted in higher energy prices, reliance on Middle Eastern oil and dependence on Sea Lines of Communications (SLOCs) for the transportation of oil to Northeast Asia, not to mention greater rivalry.

Furthermore, as a result of such competition, the full potential of Central Asia's resources is therefore not fully realized. This explains the slow pace of Central Asia's economic modernization programs, limited investment in the region and why Central Asia continues to fall under Russian influence. Thus, while there are a high number of proposed cooperative structures, very few actually seem to implement their strategies and have direct impact on the multilateral relations in the region.<sup>6</sup> In essence, regional integration is very limited with dire political and economic consequences as a result.

### **Increased Tension in Eurasia and the European Experience**

Access to and use of energy in the region is closely linked to the economic development in Eurasia. Among the Eurasian states, China has been singled out as the one with the most urgent need for new energy resources. Due to the pace of China's growth, and the resources needed to sustain its modernization program, China has been put in a position of growing dependence on energy imports.<sup>7</sup> The shortage of oil supply forced China to become a petroleum product importer since 1993 and a net importer of crude oil in 1995. Official Chinese statistics show that the volume of imported oil increased from over 20 million tons to 70 million tons from 1996 to 2002. Research by China's Ministry of Communications on marine oil transportation predicted that the country would import 100 million tons of crude oil in 2005, 150 million tons in 2010 and in 2020, the number would soar to 250 to 300 million. It is beyond doubt that China will see an increasing dependency on crude oil imports, with the amount

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<sup>6</sup> Annette Bohr, "Regionalism in Central Asia: new geopolitics, old regional order," *International Affairs* 80, 3 (2004); Swanström, Niklas L. P., "The Prospects for Multilateral Conflict Prevention and Regional Cooperation in Central Asia," *Central Asian Survey* 23, 1 (March, 2004); Swanström, Niklas L.P., "Regional Cooperation and Conflict Prevention," in Niklas L.P. Swanström (Ed), *Conflict Prevention and Conflict Management in Northeast Asia* (Uppsala & Washington: CACI & SRSP, 2005).

<sup>7</sup> Swanström, Niklas L. P., "China and Central Asia: A New Great Game or Traditional Vassal Relations," *Journal of Contemporary China* 14, 45 (2005):569-584.

of crude oil imported rising from 31 percent in 2002 to 50 percent four years later in 2007.<sup>8</sup>

As a result, China's economic growth is increasingly perceived as a threat to its neighbors because of its high energy demand and China is now perceived as a competitor of energy resources, particularly by Japan who is another major player in the quest for energy security.<sup>9</sup> Japanese demand for energy has been stagnant in recent years as a result of its slow economic growth. However, the issue of energy security continues to be an important national security issue. This is because Japan lacks significant domestic energy resources and as a result, almost all of its energy needs are imported. In 2001, the country's dependence on imports for primary energy stood at more than 79 percent.<sup>10</sup> Japan was also the second largest importer of oil just behind the United States until late 2003 when China overtook it. Japan and China's quest for energy security has resulted in competition over Iran. Japan is currently Iran's biggest importer of oil and gas but will be overtaken by China soon. Last year, Iran and China signed a preliminary accord under which China will buy 10 million tons of liquefied natural gas (LNG) per year for 25 years in a deal worth \$100 billion.<sup>11</sup>

Meanwhile, the Russians, while being heavily courted by both China and Japan for its Far Eastern energy resources have been wary of both. Russia is concerned that the demographically and economically rising China would overwhelm the Russian Far East which is suffering from a high incidence of population decline. During the late 90s, a weakened Russia needed China to maintain international relevance while China considered Russia as a potential junior ally. By 2004, the reverse has happened with Russia seeing China as a potential threat to its Far Eastern interest while China sees Russia as its route to energy security.<sup>12</sup> Russia's relationship with Japan is also not without hitches. There is also a leftover sense of historical distrust over the Japanese occupation of Siberia in the early 20<sup>th</sup> century. Furthermore, territorial disputes between Russia and Japan over the Kuril islands north of Japan which the Soviets seized at the end of the Second World War remain a prickly

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<sup>8</sup> "Half of China's oil consumption will depend on imports within four years," *China Daily*, 11 Dec 2003 <[http://www.chinadaily.com.cn/en/doc/2003-12/11/content\\_289499.htm](http://www.chinadaily.com.cn/en/doc/2003-12/11/content_289499.htm)> (March 15 2004).

<sup>9</sup> "Strategy and Approaches of Japan's Energy Diplomacy," Ministry of Foreign Affairs, Japan, April 2004 <<http://www.mofa.go.jp/policy/energy/diplomacy.html>> (June 10 2004).

<sup>10</sup> "Japan Country Analyses Brief," Energy Information Administration, Department of Energy, U.S., July 2003.

<sup>11</sup> "Iran wants China to Replace Japan as Top Oil Importer," *Channel News Asia*, November 7 2004.

<sup>12</sup> "As Russia Goes Western, China Pays the Tab," *Stratfor*, 20 August 2004.

issue between both sides.<sup>13</sup> Whoever the trading partner, energy has been identified as a key plank to Russia's diplomacy in the East and its growing energy exports to the region would result in Russia gaining considerable political leverage and strategic influence there.<sup>14</sup>

South Korea is also entering into the energy competition foray. Until the end of 2003, South Korea was the seventh largest oil consumer and fifth largest net oil importer in the world.<sup>15</sup> During the South Korean President's recent visit to the Kremlin in late September 2004, South Korean and Russian firms signed \$4 billion worth of energy contracts, most of them focused on oil. Among these, a significant deal is the \$250 million agreement signed between Rosneft, an oil corporation with close links to the Kremlin, which is about to be merged with the natural gas giant Gazprom, and the Korea National Oil Corporation to explore the oil reserves of remote Kamchatka at Russia's far northeastern tip and also the oil reserves of Sakhalin island. This deal is likely to irritate Japan especially—South Korea's historic rival in Northeast Asia. Sakhalin is right next door to it and has historic links to Japan.<sup>16</sup> In fact, Sakhalin oil supplied Japan through most of World War II and the Japanese are presently engaged with the Russians to develop the gas fields over there.<sup>17</sup>

Russia and South Korea also agreed to speed up construction projects to link Russia's Trans-Siberian railroad with the Trans-Korean Railroad in order to transport eastern Siberia's oil and gas from Russia, via North Korea, directly to its new South Korean markets. South Korean leaders appear eager for Russia to take a more active role in interceding with Pyongyang and playing a reassuring, stabilizing role in relations with it since U.S. engagement with the North Koreans have stalled.<sup>18</sup> It is also important to note that unless North Korea's dire current energy needs are

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<sup>13</sup> After the Russo-Japanese War of 1904-1905, Japan owned the southern portion of the island below the 50th parallel. Stalin's troops captured it--or recaptured it, depending on who you ask--at the end of World War II, together with the Southern Kurils (Islands), which to this day Japan claims are theirs. During a brief period between 1920 and 1925, Japan owned all of Sakhalin and even had a consortium of companies extracting oil from the northern part of the island, one of which was Mitsubishi Mining. Lucile Craft, "The Sakhalin Oil Boom Part I," Japan, Inc, July 2003.

<sup>14</sup> "The Energy Dimension in Russian Global Strategy," Baker Institute Study, October 2004, p. 10-13.

<sup>15</sup> "South Korea Country Analyses Brief," Energy Information Administration, Department of Energy, U.S., Dec 2003.

<sup>16</sup> Martin Sieff, "Russia, S. Korea Become Energy Partners," *Washington Times*, September 23, 2004.

<sup>17</sup> Lucile Craft, "The Sakhalin Oil Boom Part I," Japan, Inc, July 2003.

<sup>18</sup> Martin Sieff, "Russia, S. Korea Become Energy Partners," *Washington Times*, September 23, 2004.

resolved, tension in Korean Peninsula is unlikely to be resolved.<sup>19</sup> Without energy, it would be unable to develop economically.

Overall, we see that the rivalry and promises of bilateral cooperation which has surfaced during this process is a reflection of the complex relationship between the governments in Northeast Asia. At present, the segregation of the region is making the quest for energy security a zero-sum game played out mainly among Japan, China and Russia on a bilateral basis. It is important to note that these three countries have all been at war with each other at some point in history.

Despite the fact that tensions threaten the interaction between the Asian states today, the situation is better than it was in Western Europe directly after the Second World War. The post WWII situation in Western Europe was significantly more insecure and the political and military situation was as bleak as or bleaker than Asia today, not to mention the lack of social and economic interaction that served as a strong factor for future conflict. The European economies was in rumbles and the US and a few European states that stayed outside the war had the only effective production capacity. The few factors that where positive after the war was the immense sense of war tiredness and the strong pressure that the U.S. placed on the Western Europeans to cooperate. The Marshall Plan and the political weakness in Western Europe were prominent factors in the post war period. Despite, or possibly as a result, such conditions served to facilitate peaceful relations created among the Western European nations at a rapid phase. Focus was on how to rebuild the political and economic structures after the war, unlike after the First World War when revenge was the prime motive behind the peace negotiations.<sup>20</sup> It seems, in retrospect, evident that Western Europe would not have been able to succeed without its strong economic focus and active U.S. involvement despite the impressive growth of integration. In the 50's Europe was already relatively well integrated both politically and economically. The present-day European Union is in fact testimony to the assertion that cooperation and interdependence is the best means to achieve prosperity for all European states and for preventing future military conflict. Looking at the European Union blueprint, we would see that economic cooperation served as a good starting point for further integration of the region.

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<sup>19</sup> Kent E. Calder, "The Geopolitics of Energy in Northeast Asian," *Energy Focus* Issue 3, KEEL, (2004): 72; Niklas Swanström, "Can China Untie the Gordian Knot in North Korea?" *Korean Journal of International Studies* No. 1 (2004); Niklas Swanström & Mikael Weissman, "Chinese Influence on the DPRK Negotiations," *Peace Review* 16, 2 (July, 2004).

<sup>20</sup> Matthew Hughes & Matthew Seligmann, *Does Peace Lead To War: Peace Settlements and Conflict in the Modern Age* (Gloucestershire: Sutton Publishing, 2002).

In 1951, the European Coal and Steel Community (ECSC) was created, and successfully helped the devastated economies of Western Europe, especially France and Germany, to rebuild the economic structures closely together. As a result of ECSC, it was virtually impossible to rebuild the military without the knowledge of other states since such a process would require large amounts of steel. As economic activity increased, so did the level of trust among the European states and cooperation from the economic sphere improved relations which in turn spilled over to the military and political sectors. Today the warring European states of the Second World War is integrated to an extent unheard of and this has made war between the different states very difficult and unlikely, if not impossible. What was very difficult to accomplish politically after a violent war, was accomplished through economic means and through the assistance of the U.S. that committed both political and financial resources to the rebuilding of Western Europe.

The situation is in many ways more positive in Asia today, even if political and military tensions from past military conflicts and occupations still persist. The economic and social interaction among all actors is higher than Western Europe in 1945, save North Korea and Turkmenistan. This is especially true in Northeast Asia where all economic entities are closely integrated, even in the case of Taiwan and mainland China. Nevertheless, the overall situation in Eurasia, both from an economic and political perspective, remain dire and is in need of formalized cooperation and confidence building measures that would tie the states together both politically and economically. While the lack of multilateral energy cooperation appears dismal, it also presents an opportunity for states in the region to work together. An oil and gas union could in fact serve as a common ground for discussion on energy security that could impact economic and investment decisions as well as the political interaction, a request that has been raised before.<sup>21</sup> The question of energy cooperation is in this context important as multilateral energy cooperation could create permanent relations of mutual engagement and cooperative interdependence thus mitigating the potential of violent conflict in Eurasia.

### **Possible Implications of an Asian Oil and Gas Union:**

That there are tremendous gains from an Asian oil and gas union is obvious, not only in terms of bringing state together in the long run, but more importantly in the short run there are economic improvements and

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<sup>21</sup> Vladimir Ivanov, "An Energy Community for Northeast Asia: From a Dream to Strategy," *ERINA Report* 52 (June 2003) <[www.erina.or.jp/Jp/Research/db/rep15/RS-EE/04070.pdf](http://www.erina.or.jp/Jp/Research/db/rep15/RS-EE/04070.pdf)> (October 30, 2005).

visible economic gains for the states involved. The benefits could be divided into political trust, economic development, deregulation, environmental improvements, decreased political reliance on oil exporters, increased national security etc. of which a few will be discussed here but other issues could be found elsewhere.<sup>22</sup>

Politically, increased energy diversification and increased energy security would be a tremendous asset. By decreasing its reliance on one, or a few states, each individual actor would have more possible actors to trade with at more financially sound levels and not as today pay an Asian Premium for oil deliveries.<sup>23</sup> This is high on most states agenda, but fear of strengthening other actors have hindered this much needed diversification, a diversification that could be gained through Russian, Central Asian and Iranian oil and gas.

The economic implications with an increased cooperation among the Eurasian states would be tremendous. Enhanced regional cooperation would decrease the reliance on the SLOCs and the reliance on Middle Eastern oil that today is the most important provider of oil in Northeast Asia. Currently, there is a premium on the oil that is imported to Northeast Asia on \$1-2 per barrel, this is due to the reliance on Middle Eastern oil and the lack of competition, but also due to the simple fact that Middle Eastern oil is high cost oil and that freight costs are prohibitive.<sup>24</sup> The waterways are today forced to be drawn outside of the normal waterway due to water depth in the Malacca Straits which forces the prices up. There is also a lack of transparency in the oil industry that has made the price much higher than it should have to be. The total import of oil was 13.7 MBD in 2000 and with the above mentioned

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<sup>22</sup> Shoichi Itoh, Vladimir I. Ivanov and Zha Daojiong, "China, Japan and Russia: The Energy Security Nexus," in Niklas L.P. Swanström (Ed), *Conflict Prevention and Conflict Management in Northeast Asia* (Uppsala & Washington: CACI & SRSP, 2005); Kyudok Hong, "Dilemmas of South Korea's New Approaches to Conflict prevention," in Niklas L.P. Swanström (Ed), *Conflict Prevention and Conflict Management in Northeast Asia* (Uppsala & Washington: CACI & SRSP, 2005); Ingolf Kiesow, "A Perspective from Pyongyang through Foreign Glasses," in Niklas L.P. Swanström (Ed), *Conflict Prevention and Conflict Management in Northeast Asia* (Uppsala & Washington: CACI & SRSP, 2005); Philips Andrews-Speed, "Energy Security in East Asia: A European View," Paper presented at the Symposium on Pacific Energy Cooperation 2003, Tokyo, 12-13 February 2003, pp. 6-8; Kim Hyun-Jae and Shim Sang-Yul, "Operation and Support of the SOM and Conference for Energy Cooperation in Northeast Asia," KEEI (March 2004).

<sup>23</sup> Karen Teo, "Big Three to Fight 'Asian Premium' on Saudi Oil Sales," *Energy Bulletin* November 24, 2004 <[www.energybulletin.net/3349.html](http://www.energybulletin.net/3349.html)> (October 30 2005); Masayoshi Soga, "Regional Cooperation for Resolving the Asian Premium," *IEEJ*, (March 2004) <<http://enen.iej.or.jp/en/data/pdf/245.pdf>> (October 30 2005).

<sup>24</sup> Henry Kenny, "China and the Competition for Oil and Gas in Asia," *Asia-Pacific Review* 11, 2 (2004); Masayoshi Soga, "Regional Cooperation for Resolving the 'Asian Premium,'" *IEEJ* (April, 2004).



premium it would equal \$5-10 billion per year in extra costs for the Northeast Asian economies. Opening up the Central Asian and Russian energy resources to Northeast Asia would thus significantly decrease the economic costs for the regional economies, as well as increase investments in the economically weaker Central Asian states and Russia.

The energy need is growing quickly in Eurasia. In 1971 the Asia Pacific region was responsible for a mere 14.8 percent of the world's primary energy supply and this has increased to 28.1 percent in 2000 and will increase to 34.9 percent in 2030.<sup>25</sup> The bulk of the increase is in the developing states in Asia, especially China, which has a growing need of energy resources.<sup>26</sup> This will result in increased dependency on the Middle East if diversification of energy imports is not realized and if domestic energy alternatives are not found. Dependency on oil in Asia was little above 70 percent in 2000 but could be significantly higher than 90 percent in 2030.<sup>27</sup> It is apparent for most analysts that if this continues Northeast Asia will face severe energy shortages, both short and long term. This will have a negative effect on energy security in the region and should force the regional economies to collaborate with each other to decrease the reliance on external actors. The financial gains should be a significant motivation alone, if not for any other reason.

However, it could be argued that there is no shortage of energy, it is much more a lack of energy efficiency. This in terms of transit, refinery, and usage. Japan is the only state in the region that has sufficient energy efficiency, South Korea's energy efficiency is weaker and in the other states it is dismal.<sup>28</sup> There is a need to increase the energy efficiency, in terms of production, transit, and usage that are badly managed in today's Eurasia. Improvements would not only decrease prices, but also increase availability and reduce environmental degradation. It would also improve the technical expertise on a general level in the region. This would imply that energy would be much cleaner than it is today, and could substantially improve the environment in Eurasia, an improvement worth attention in itself.

Creation of a more competitive and transparent energy market is a crucial factor if the economy behind the oil and gas union would have

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<sup>25</sup> Secondary source: Kazuya Fujinme, "Asia needs to construct a framework of energy cooperation & joint research," *IEEJ* (March 2003): 1.

<sup>26</sup> *Ibid.*, p. 2.; Pak Lee, "China's quest for oil security: oil (wars) in the pipeline?," *The Pacific Review* 18, 2 (June 2002).

<sup>27</sup> Kazuya Fujinme, "Asia needs to construct a framework of energy cooperation & joint research," *IEEJ* (March 2003).

<sup>28</sup> Emma Chanlett-Avery, *Rising Energy Competition and Energy Security in Northeast Asia: Issues for U.S. Policy*, CRS Report for Congress, The Library of Congress (July 14, 2004).

any substantial effect; currently the energy market in Eurasia is markedly regulated and inefficient from an economic perspective.<sup>29</sup> The improvement of the energy market, deregulation, transparency and harmonization of standards, would have positive repercussions on the overall economic integration and stimulate trade if it would follow the European experience. It should be noted that the benefits from initiating such multilateral cooperation does not bear fruit only with the completion of such an energy network. The process which involves technical complexity, uncertainty, and longer time horizons could in fact foster peace-making types of cooperation and enhance inter-state relations as it requires greater interaction and coordination of policies between governments which, in turn, would help to facilitate greater understanding and foster goodwill among participants.<sup>30</sup>

### **Energy drain and possibilities**

The need for oil and gas cooperation is very high in all states. The economic gains would be tremendous for all states involved, especially as the energy needs are increasing rapidly in all states in the world. However, energy cooperation is not a new phenomenon in Eurasia. For example, energy cooperation was an idea that facilitated the Sino-American rapprochement in the 1970's that brought China and the U.S. together for the first time since 1945. It was also a central factor behind the Sino-Soviet normalization in the 1980's and Russian-Korean normalization in the 1990's.<sup>31</sup> In all of these three cases energy functioned as something facilitating and soothing on the political relations. Historically there are several more examples of how energy has been utilized to bridge poor political relations, even if this can be perceived as more controversial. Despite this, governments in the region have been very reluctant to further integration. This is partly a result of the political competition, but also of a traditional realist fear that the economic gains are relative and that strengthening the enemy is all but an option.

Despite this, energy integration is a crucial measure in Eurasia, both from a political and an economic perspective. Politically it would greatly benefit the cooperative structures that has been initiated in the region, but which has encountered problems progressing. Energy integration would also increase trust between actors at all levels of society.

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<sup>29</sup> Kazuya Fujinme, "Asia needs to construct a framework of energy cooperation & joint research," *IEEJ* (March 2003).

<sup>30</sup> Philips Andrews-Speed, "Energy Security in East Asia: A European View," Paper presented at the Symposium on Pacific Energy Cooperation 2003, Tokyo, 12-13 February 2003, pp. 6-8.

<sup>31</sup> Gaye Christoffersen, Problems & Prospects for Northeast Asian Energy Cooperation, Paper presented at IREX, March 23, 2000.

Economically it would greatly benefit the states in the region by decreasing costs, improving technical issues and securing long term energy security. Currently we have seen several attempts to bilateral and trilateral energy cooperation and even some cases of multilateral energy cooperation such as ASEAN+3, Shanghai Cooperation Organization and Northeast Asian Economic Forum. A problem is that neither cooperative structure takes into account the need to include all actors starting from the source of the natural resources (Central Asia and Russia), refining point (mixed), transit (Central Asia, Mongolia, Russia, China and possibly Iran) and consumer states (primarily Northeast Asia). In order to create a common strategy over oil and gas in Eurasia it is crucial to create a sound economy behind this cooperation and this can only be accomplished with all actors being involved and integrated. Successful integration needs to include all available actors in a truly multilateral forum. There have been several suggestions how to go about regional cooperation in energy issues.<sup>32</sup> Still, there are unfortunately very few mechanisms in the region to further such integration.

Lack of trust between the different actors, internal economic considerations, failure to open up the economies and energy sector because of sovereignty fears have limited cooperation avenues. What is needed is political commitment and strong economic incentives for the regional economies and non-state economic actors to integrate and work closely together. Each individual state has its own strong commitment to this, but they are rarely compatible with other states unless they are directed towards a third state. In fact, it has been noted that the key problem in realizing such an energy cooperative network is the issue of coordination and distrust. The competing countries have to date depended on their own limited solutions in pursuing their own cooperative measures bilaterally without concerted policy directions between countries and often at the expense of their neighbors thus producing animosity. Furthermore, the business sector has been developing and doing its cooperative energy projects without clear policy directions at the government level.<sup>33</sup> Thus, we note that realist thinking and zero-sum game strategies are very apparent in the thinking of many policy-makers. This has made it very difficult for any structure in the region to over bridge the lack of trust. To accomplish this it is necessary

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<sup>32</sup> Vladimir Ivanov, "Creating a Cohesive Multilateral Framework Through a New Energy Security Initiative for Northeast Asia," *ERINA Report 55* (December 2003) <[www.erina.or.jp/En/Research/Energy/Ivanov55.pdf](http://www.erina.or.jp/En/Research/Energy/Ivanov55.pdf)> (October 30 2005).

Vladimir Ivanov, "An Energy Community for Northeast Asia: From a Dream to Strategy," *ERINA Report 52* (June 2003) <[www.erina.or.jp/Jp/Research/db/rep15/RS-EE/04070.pdf](http://www.erina.or.jp/Jp/Research/db/rep15/RS-EE/04070.pdf)> (October 30 2005).

<sup>33</sup> Kim Hyun-Jae & Shim Sang-Yul, "Operation and Support of the SOM and Conference for Energy Cooperation in Northeast Asia," *KEEI* (March 2004): 3.

to rely on an organization that has an excess of political capital and currently there are no such organization in Eurasia.

One organization that is partly an exception is the SCO which is well positioned to initiate such cooperation over energy, both in an effort to improve political relations but more importantly to improve the economic situation for all actors. This is possible due to the strong political commitment China and a few Central Asian states have placed in the organization. It would play into the strategy that China has to further this organization as the primary multilateral organization in the region, this is however an attempt that Russia and Uzbekistan is less enthusiastic about. Russia would like to promote Commonwealth of Independent State as the primary organization in the region, as it controls it while Uzbekistan would like to engage the Central Asian states either bilaterally or in a truly Central Asian organization it would dominate. However, in order for the SCO to act as the vehicle for an oil and gas union, the SCO would need to include some of the more important energy consumers such as South Korea, Japan and even possibly Taiwan and production states such as Iran in order to make it economically viable. There are currently very little economic incentives to further such a plan and the capital investments involved are so large that the private sector would be reluctant to take all the cost by themselves.

This is not impossible, and most states acknowledge the need for further integration. China developed a strategy for energy security in the 1990's called the "Pan-Asian Continental Oil Bridge" that would link Japan with Middle East under Chinese control.<sup>34</sup> This is seen as something positive from a Chinese perspective where the regional economies could be tied up against one other, other actors in the region meanwhile viewed this as an attempt by China to dominate the regional markets. It is without doubt that states that would control the transit routes to the consumers would have increased influence in the region. Politically they would be able to impact the foreign policy of the states dependent on the transit. This is also one reason that Japan and Taiwan have opted for the sea lanes before a Chinese pipeline and why the Japanese proposed a pipeline from Angarsk to Nakodha which skirts around Chinese territory. Politics, not economics was the key factor of consideration in such a pipeline.<sup>35</sup> This proposal has taken precedent over the Daqing initiative that was proposed by China and that was less than half as expensive to construct compared to the Nakhodka pipeline. However,

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<sup>34</sup> Gaye Christoffersen, Problems & Prospects for Northeast Asian Energy Cooperation," Paper presented at IREX, March 23, 2000.

<sup>35</sup> "Daqing Pipeline Still Most Feasible," China.org.cn website, March 11, 2004 <[www.china.org.cn/english/2004/Mar/89979.htm](http://www.china.org.cn/english/2004/Mar/89979.htm)> (October 15 2005).

political and other economic considerations in Russia have made the Japanese initiative a more likely option, even if the Chinese will do anything in their power to prevent this from realizing. From an economic perspective, keeping more than one transit route will at the current market structure prove to be economically unviable and would threaten the commercial involvement in any pipeline that are under construction or planning.

Other initiatives that have been considering energy cooperation, either as a purely economic initiative or as a peace creator, has been Council for Security Cooperation in the Asia Pacific (CSCAP), the Japan America China Conference, ASEAN+3<sup>36</sup>, Northeast Asian Economic Forum, Tumen River Area Development Program as well as the APEC Energy Working Group (EWG). The EWG's structure makes it an interesting organization, but as Central Asia is outside EWG's focus, it is not applicable here and all Northeast Asian states have included Central Asia in their energy strategy which thus makes EWG and the above mentioned organizations somewhat obsolete.<sup>37</sup> The other organizations suffer from several shortcomings that make them less likely to be used effectively. Politically there is a problem getting the different states to compromise over the energy structure as energy is seen as a political tool in many capitals. The political considerations are particularly problematic as they prevent economic development and increased trust at levels other than the political. There are also huge hurdles for the private sector who would like to venture into this project. If the private sector is to assume this role and bear the cost, the market would have to deregulate quickly and open up negotiations on transit fees. States would also have to commit to future engagement in carrying out such liberalization programs.

### **Challenges and national considerations**

Challenges to an Asian Oil and Gas union are many and politically there is a growing conflict over influence in Central Asia and Northeast Asia. China and Russia is engaged in a more or less open, conflict over influence in Central Asia. The traditional Russian influence is decreasing

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<sup>36</sup> Shoichi Itoh, Vladimir I. Ivanov and Zha Daojiong, "China , Japan and Russia : The Energy Security Nexus," in Niklas L.P. Swanström (Ed), *Conflict Prevention and Conflict Management in Northeast Asia* (Uppsala & Washington: CACI & SRSP, 2005).

<sup>37</sup> Vladimir Ivanov proposes that APEC should be the structure on which a Northeast Asian security initiative should be built, however APEC does not include Central Asia. The dependency on Middle Eastern oil should be one of the primary consideration (???) and relying solely on Russian oil and gas will not solve Northeast Asia's energy security issues. Vladimir Ivanov, "Creating a Cohesive Multilateral Framework Through a New Energy Security Initiative for Northeast Asia," *ERINA Report* 55 (December 2003) <[www.erina.or.jp/En/Research/Energy/Ivanov55.pdf](http://www.erina.or.jp/En/Research/Energy/Ivanov55.pdf)> (October 30 2005).

and China is attempting to move into this region rapidly, the last thing Russia is willing to do is to assist China in this strategy, CIS and SCO are thus put in a position where they could potentially be forced to compete with each other. Until now, political considerations from both Russia and China has made it valuable to cooperate to decrease the U.S. influence in the region and neither organization has become so strong as to create any stir in Moscow or Beijing. It will not be until the political relations between Russia and China is tested that SCO will be baptized. Bilateral relations between China and Russia will to a large degree determine the future of SCO, at least until it has become so powerful by its own that it can distance itself from regional power struggles. The question is of course if SCO will ever be allowed to distance itself from national considerations.

Northeast Asia suffers from a situation that in essence is the same as that which is witnessed in Central Asia between China and Russia. China and Japan is engaged in a regional power struggle, whereby China is increasing its political influence in the region at the expense of Japan. In both of the regions there is a feeling in the U.S. that China should not be given a *carte de blanc* to exert influence unchecked. This attitude is closely connected to the dissatisfaction of China's close relations with so called "rogue" states, specifically in communist North Korea and Islamic Iran. In the economic field there is also concern over how China's growing economy is casting a shadow over its neighbors, the Chinese economy is rising at a rate that is truly worrisome for states that has traditionally been stronger, such as the U.S., Japan and to a certain extent Russia. Moreover it is imperative for many smaller economies that they are not dominated by a growing Chinese economy. This said, the concerns of China are likewise many and focuses on energy security, fear of being surrounded by hostile states, and a strong concern for domestic economic development. The Chinese leadership believes that this can only be accomplished by increasing international contacts and economic integration, while maintaining Chinese sovereignty and measures to protect its national security considerations.

Iran is a state that cannot be ignored from a pan-Eurasian energy cooperation viewpoint. It can be perceived either as a problem or an advantage depending from which perspective we look at it from. While China, Japan and most Eurasian states are positive towards the inclusion of Iran in the Eurasian energy network, such a move will most certainly alienate the US and even create a dispute with the U.S. over time.<sup>38</sup>

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<sup>38</sup> Emma Chanlett-Avery, *Rising Energy Competition and Energy Security in Northeast Asia: Issues for U.S. Policy*, CRS Report for Congress, The Library of Congress, July 14, 2004.

Iran would however serve Eurasia positively as it would increase the flow of oil to Eurasia and possibly make the pipelines economically sustainable more quickly. The Eurasian economy could be sustained to a significant degree with Iranian oil, even if pipelines with Iranian oil would spur political instability as the U.S. will work against usage of such pipelines. From an economic perspective, it would be foolish not to serve Eurasia with one single pipeline that could carry the investment costs better. One argument which could be put forward to justify Iran participation would be that by incorporating Iran into a multilateral institutional framework, it could create conditions for a more moderate Iran through interdependence linkages. On the other hand, this would of course also give Tehran some degree of political legitimacy and render sanctions useless if sanctions are the primary objective.

In the creation of the Asian oil and gas union, it must be pointed out that there are several problematic economic considerations to make, that will complicate the economic sustainability of the pipeline. For one, resources and markets are very far apart and major infrastructural projects need to be implemented to make this possible. It is no coincidence that there are more talks about pipelines than actual pipelines being initiated, the costs are prohibitive, especially as long as there are several projects that are competing and pipelines that are not connected to each other. This infrastructural problem is one major issue that an oil and gas union would have to look at, since it is at the heart of profitability and viability of the projects.

As mentioned, the projects are too large for private businesses and there is some reluctance among the governments in the region to invest in "competing" projects and this lack of coordination is most disturbing. States and private capital need to cooperate in investing for the future, but the insecurity is too high at the moment due to lack of deregulation and because of the number of competing projects. It has been estimated that the upstream sector is an extremely high/risk sector with a success ratio of 10 percent or so, a figure far below what is accepted by private investors.<sup>39</sup> This calls for both economic and political initiatives by the government to create stable transit fees and tariffs. These are measures that are not easily accomplishable without a strong regional organization that could bring the issues forward with the best interest of the region at mind, rather than for benefit of specific states only.

The picture is further complicated by the fact that many external actors would view the development of an Asian Oil and Gas Union with suspicion as it would not only increase the economic strength of the

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<sup>39</sup> Kensuke Kanekiyo, "The Northeast Asia Natural Gas Pipeline Network," *IEEJ* (March 2004): 8.

actors involved, it would also integrate these actors economically as well as politically over time. The formation of such a bloc is perceived as a threat by many actors as it would decrease the political and economic influence that the EU, the Middle East, and most importantly, that the United States would have over Eurasia. If such a grand project is to succeed, it needs strong external support similar to that which was received during the formative period of the ECSC-EU project. Perhaps it is time for the U.S. and Europe to act and play a more constructive role in the region over this matter. Notably, the European Union has been especially weak in its support for Eurasian regional integration and energy cooperation, in disregard of its own success story.

### Conclusions

It is deemed necessary to create effective regional structures to improve the overall political and economic environment in Eurasia. This has shown to be very difficult to manage with political integration, as there are a great reluctance to go further down this road. In the economic field, the situation looks much more positive and the creation of an Asian oil and gas union would be most important for the development of cooperative structures, conflict management structures and a basis to develop political trust between the different actors. The economic sector seems to be more open for cooperation than the political or the military. All states are increasingly dependent on economic development for political purposes, internal stability or international standing. This is why the economic sector is acceptable for regional cooperation and integration. Nowhere is this more acute than in the energy sector.

It seems to be very difficult to further increase the possibilities for real economic integration in the energy field without deregulation of the market and a more open energy economy. Government involvement in the energy sector have severely eschewed the market and increased the financial costs for oil. There is necessity to improve the economic sustainability of each project by large cooperative structures, i.e. oil and gas union, as there is limited profitability in the small-scale projects that we see today. It would even in some cases make economic sense to continue importing expensive oil from Middle East. A major problem that has haunted the region is the lack of willingness to compromise by the various governments in the region as each has their own national agenda; without a strong external actor, this trend is set to continue.

Economically, more intense cooperation would decrease the economic costs for the Northeast Asian actors involved whose energy needs are growing, and increase resources for the weaker economies in Central Asia; it would also decrease the reliance the regions today have on Middle Eastern oil and reduce Russia's grip of the Central Asian energy sector.



Decreased political dependence on Middle East and the SLOCs as well as decreased costs for oil and increased energy security are a few major improvements with an oil and gas union. There seems to be little real willingness of the national governments to engage fully in the creation of an oil and gas union, it seems much more likely that the private sector would be willing to engage in this as an economic venture, provided the political conditions are right. (Private capital is already flowing back and forward between the different states and little consideration is put on the origin of the money.) However, private capital alone is however not enough for this sort of project, thus states would need to engage in this, either as the primary actors or as support actors in terms of financing and political support. In this sense, while governments may find it difficult to lead such a project due to the inter-state political rivalry, it could perhaps play a constructive role by backing their respective private sectors to venture into such a project. If every government is willing to assume such a position, their own corporations would find it easier to structure the domestic energy markets for further regional integration with the other energy markets in the neighboring economies. If the private sector in every state carries this out, and negotiation is able to take place among the private sector of the various states, with backing by their own government, the political edge of the Asian Oil and Gas Union project would be blunted and the economic viability of the project more attractive and realistic.

The general climate in the region have to change from a zero-sum game and relative gains to a more appropriate view of a win-win approach where all actors acknowledge others rights and where all try to maximize their benefits and at the same time increasing the neighbors part of the pie. This is necessary for the modern economic world where deregulation and free trade has gained in importance. APEC, WTO and other economic organizations would need to provide strong support in this endeavor, especially as some economies are more problematic than others.

In relation to the international organizations there is a strong need for other states, primarily the EU and the U.S. to better engage the region in terms of energy cooperation and assist in creating new economic structures. It is very much in the interest of the EU and the U.S. to improve the regions energy security, especially its energy efficiency and environmental record. This can best be accomplished through regional organizations, such as an oil and gas union. The problem here is for the external actors to see the win-win situation and refrain from seeing things as purely relative gains.