

## Building an Asian Energy Buyers' Club

Written by Gal Luft

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This week's meeting of Asia-Pacific energy ministers in Beijing is a good opportunity for countries on both sides of the Pacific to address perhaps the most unifying challenge in Asia: energy insecurity. For all their differences and historical grievances, Asian countries share the need to strengthen energy security while addressing the environmental challenges that come from fast-growing consumption.

Turmoil in the Middle East, instability in Nigeria and sanctions on Iran and Russia highlight the urgency of reducing the Asian transportation system's dependence on oil, an expensive commodity facing constant supply risk. Despite the chronic volatility of the oil market, most of Asia's cars are still made to run on nothing but petroleum.

The problem is particularly acute because Asia lacks the emergency petroleum reserves enjoyed by European and North American countries. Thus the Asia-Pacific region is uniquely vulnerable to the crippling oil shocks that will no doubt come.

Where electricity supplies are concerned, Asian economies suffer from overreliance on coal and limited interconnectedness. Worse, their ability to shift to cleaner burning natural gas is hindered by an anachronistic pricing mechanism—across the whole region—that keeps the price of natural gas indexed to that of oil products. This artificially raises gas prices higher than they would be if the two commodities were traded separately.

Asia's spot price for imported liquefied natural gas ranges today from \$13-\$18 per million British thermal units, or roughly four times the price in North America. The oil indexation system also puts upward pressure on the price of piped gas, giving bargaining power to neighboring suppliers such as Russia.

Asia's system of buying gas but paying for oil—akin to buying water but paying for Champagne—imposes a hidden tax that prevents natural gas from competing not only against coal in power generation but also against oil in the transportation sector. And the burden of high gas prices is likely to become heavier as oil prices are likely to continue rising. The inability of natural gas to compete against coal and oil denies Asia its most effective mechanism to combat air pollution—switching to a cleaner fuel.

Asia's energy landscape today is a cluster of segregated markets, each operating on its own, with little regional cooperation. This arrangement breeds unilateralism and resource conflicts of the kind we increasingly see in the Western Pacific.

Under the current international legal framework, based on the United Nations Convention on the Law of the Sea, one country can claim all the resources in its economic waters while its neighbors receive nothing. This approach fomented conflict and hinders exploration. But if the members of the Asia-Pacific Economic Cooperation forum created a new mechanism for joint multinational investment and shared development of the region's resources, exploration activity would enlarge the regional energy pie, with all parties enjoying increased supply and lower prices.

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Asia can learn from Europe's experience. During the century between the second industrial Revolution and 1945, Europe was consumed by wars over access to coal and steel in the contested Rhine and Ruhr areas. In 1951 war-weary Europeans finally came together to establish the European Coal and Steel Community to enhance regional cooperation on natural-resource matters. That mechanism eventually morphed into today's European Union.

A similar energy community can be created in Asia to cultivate shared infrastructure, strategic oil and gas reserves, and cooperative development of offshore and unconventional energy sources. Such a community could take advantage of Asia's collective buying power, essentially creating a "buyers' club" for crude and natural gas—and delinking the price of the two commodities. Asian economies would then have stronger bargaining power vis-à-vis energy exporters.

Cooperation could also erode oil's monopoly over transportation fuels. As producers of roughly half the world's vehicles, China, Japan, South Korea, Thailand and Indonesia can work together to produce cars that run on non-petroleum fuels such as alcohol (ethanol and methanol), natural gas and electricity. Such multi-fuel cars—it costs only \$100 extra per vehicle to have a flexible fuel engine that can burn any blend of gasoline and alcohol, according to the U.S. Energy Security Council and others—would not only reduce the region's oil dependency but also enable Asian consumers to shift from gasoline to cheaper alternatives should the price of crude spike.

As a rising energy superpower and soon-to-be major energy exporter, the United States would surely welcome an initiative that reduces regional tension while calming energy markets. Washington recognizes that without stronger cooperation, Asia will be prone to conflict and its economic engines may not roar for much longer. Since the U.S. maintains close relations with most APEC members, it could midwife such an initiative rather than merely cheerlead. This, rather than further military buildups, could be the centerpiece of America's "pivot to Asia."

*Gal Luft is co-director of the [Institute for the Analysis of Global Security](#), senior adviser to the [U.S. Energy Security Council](#)*

*and co-chairman of the [Global Forum on Energy Security](#) in Beijing.*

*He will be sharing more insights at [Singapore Energy Week](#) 2014 in October.*

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