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Asia the energy pivot

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Photography
Alamy, Claudio Brufola, Corbis, Contrasto-Reuters, Getty Images, Sie Masterfile, Tips

Editing and production
Agi, via Ostiense, 72 - 00154 Roma
tel. +39 06 51996254 -385
fax + 39 06 51996286
e-mail: info@abo.net
www.abo.net
@AboutOil
www.facebook.com/ABOaboutoil

Design
Cynthia Sgarallino
Graphic consultant
Sabrina Mossetto
Graphics and layout
Imprinting www.imprintingweb.com

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Piazzale Enrico Mattei, 1
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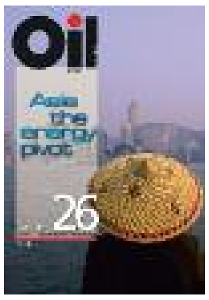
The energy pivot



by GIANNI DI GIOVANNI

"Pivot to Asia": the Obama administration coined this phrase to embody its new—and up to now largely unfulfilled—shift in focus away from traditional western and Mediterranean regions toward the East. It seemed appropriate as an inspiration for the title of an edition of Oil dealing in large part with one of the most significant issues affecting global political, economic and military stability in the coming decades: the sudden rise of Southeast Asian countries as potential key players on the international scene. The repercussions of this development, already being felt, will significantly affect relations between countries all over the globe.

The picture painted on the pages that follow is both fascinating and worrying. It involves not only China and India—their involvement is no surprise—but also the ASEAN countries (Cambodia, Thailand, Vietnam, Laos, Brunei, the Philippines, Malaysia, Indonesia, Singapore and Myanmar), which are managing, to varying degrees, remarkable levels of economic growth at a time when the western model has been in trouble.

This will mean any number of radically new economic and commercial scenarios, each of which will spawn new prospects for and challenges to global diplomacy. But what it means most of all – and Oil cannot help but be interested in this part of the story – is extraordinary repercussions, many yet even to be imagined, for the commodities market and especially for energy. These resources are fundamental to fueling growing economies, and, not by coincidence, they are also invariably the decisive stake in the larger political and diplomatic games that occupy nations, not to mention the trigger for all too many disputes and wars.

Obama's heralded "Pivot to Asia" strategy is a leading indicator – greatly underestimated by public opinion – of how things are changing, even if the White House's actions so far haven't amounted to much. And so it seemed important to us to put the spotlight on this issue.

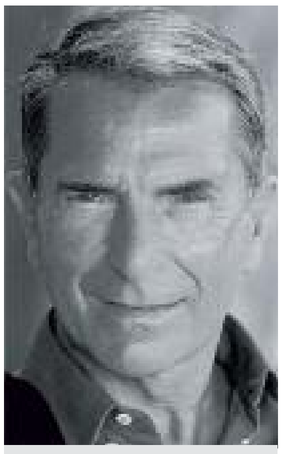
In this edition of Oil, the reader will find a series of articles by experts analyzing the current situations and future prospects of the key countries in the great Asian economic and industrial explosion. You'll encounter detailed examinations of how the choices of key regional players and world powers are evolving and what effect this is likely to have on the energy markets. It will include a special focus on Europe and what the Old Continent can do to escape its seemingly inevitable role as co-star on the world stage. In this regard, we have referred extensively to the "Eurasia, geoeconomic frameworks and global information" workshop, promoted by the AGI press agency, Sapienza University of Rome, the "Fondazione Roma-Mediterraneo" and under the patronage of the Italian Ministry of Foreign Affairs.

Our goal in creating Oil 26 has been to tackle this essential story's major elements—elements to which we shall inevitably return in the future.

CONT

opinions

The “leap forward” arrives from the Far East



CARLO ROSSELLA
Carlo Rossella is a journalist and executive. He has been the head of *La Stampa*, *Panorama*, TG1 and TG5 (the TV news programs). He is currently chairman of Medusa Film, the production company of Mediaset.

China’s GDP is growing, on average, by 7.75 percent per year. The Dragon possesses great energy. But the Asian tigers, from Malaysia to Indonesia to Singapore to South Korea are going all out. And Japan, thanks to the policies of Prime Minister Shinzo Abe, has come out of stagnation. In brief, “the new horizon is in the East,” is what the economists and political commentators are saying. The economic crisis, which began in 2008, caused a shift in the axis of global development from the West to Asia, where unprecedented levels of growth are being recorded. In the space of a few years, China could become the number one global economic power, overtaking the United States. Just go to Beijing or Shanghai and talk to the politicians, economists, managers, bankers or businessmen to breathe in the climate of great optimism and even a certain arrogance due to the undeniable successes of a resounding “great leap forward,” to quote the words of Chairman Mao. But this great leap forward relies on others’ oil rather than its own energy sources, except for coal, which cannot be used to run the millions of cars now congesting the streets of China’s major cities.
The West is waging a psychological war against Putin, hitting him with sanctions on account of his policy in Crimea, restricting energy imports from Russia. But Putin is laughing it off because China is now his most precious ally, as opposed to Europe (excluding Germany). Moscow, like a large part of the western world, is looking to the East, where economic development and political stability offer tremendous opportunity.
The problems, for everyone, are emanating from the Middle East and Mediterranean Africa, especially Libya and Syria. There are tribal clashes in Libya. In Syria and in neighboring Iraq, the governments are fighting a low level war against a new organization. It is the Islamic State, formerly ISIS, an extremist organization, the enemy of Christians, Shiite Muslims and Baathist laymen. Its Caliphate, led by Abu Bakr al Bagdadi, is overflowing with black gold. Mosul, the Iraqi center for extraction, fell into its hands. After the conquest of Mosul, the Islamic State took over the central bank of the city and seized gold ingots and approximately 450 million dollars in cash. All in all, the Islamic State has taken in a haul of almost a billiion dollars, making it one of the richest terrorist groups in the world. This is how it became one of the richest terrorist groups in the world. They also control areas rich in black gold, like the Syrian oil fields of Raqqa, Deir al-Zor and Al Omar. But who are the Islamic State terrorists selling this oil to? It seems astonishing, but the Syrians are the main customers but according to some in the western intelligence services, the Syrians are the main customers. “We have proof that things are going in this direction,” said the French Foreign Minister, Laurent Fabius, a few weeks ago. In addition to oil, the Islamic State is also gaining control of water sources, a precious commodity in the Middle East. Terrorism, low-level war, capturing wells and oil pipelines—to sum up, the Islamic State is looking to the future and intends to remain in power for a long time. Next stop, Baghdad. ■

The problem of energy sources is China’s main concern. And China’s concern is a major source of satisfaction for Vladimir Putin

E N T S

● Welcome to *Oil*, a publication of news and ideas for the energy community and beyond. It provides authoritative analysis of current trends in the world of energy, with particular attention to economic and geopolitical developments.
● *Oil* is published by Eni with the aim of fostering open dialogue about the challenges of making energy a reliable and sustainable contributor to social and economic development.
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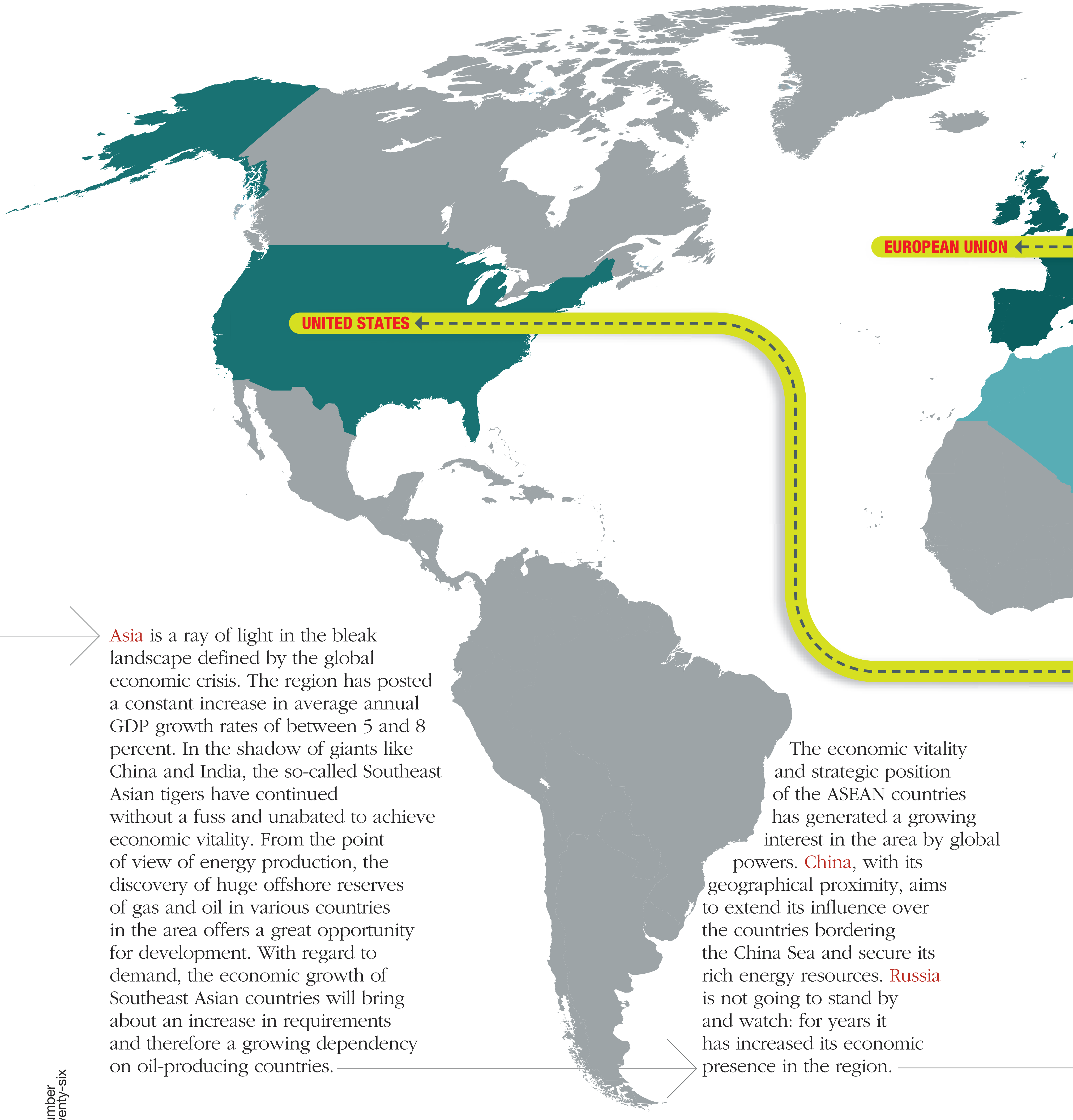
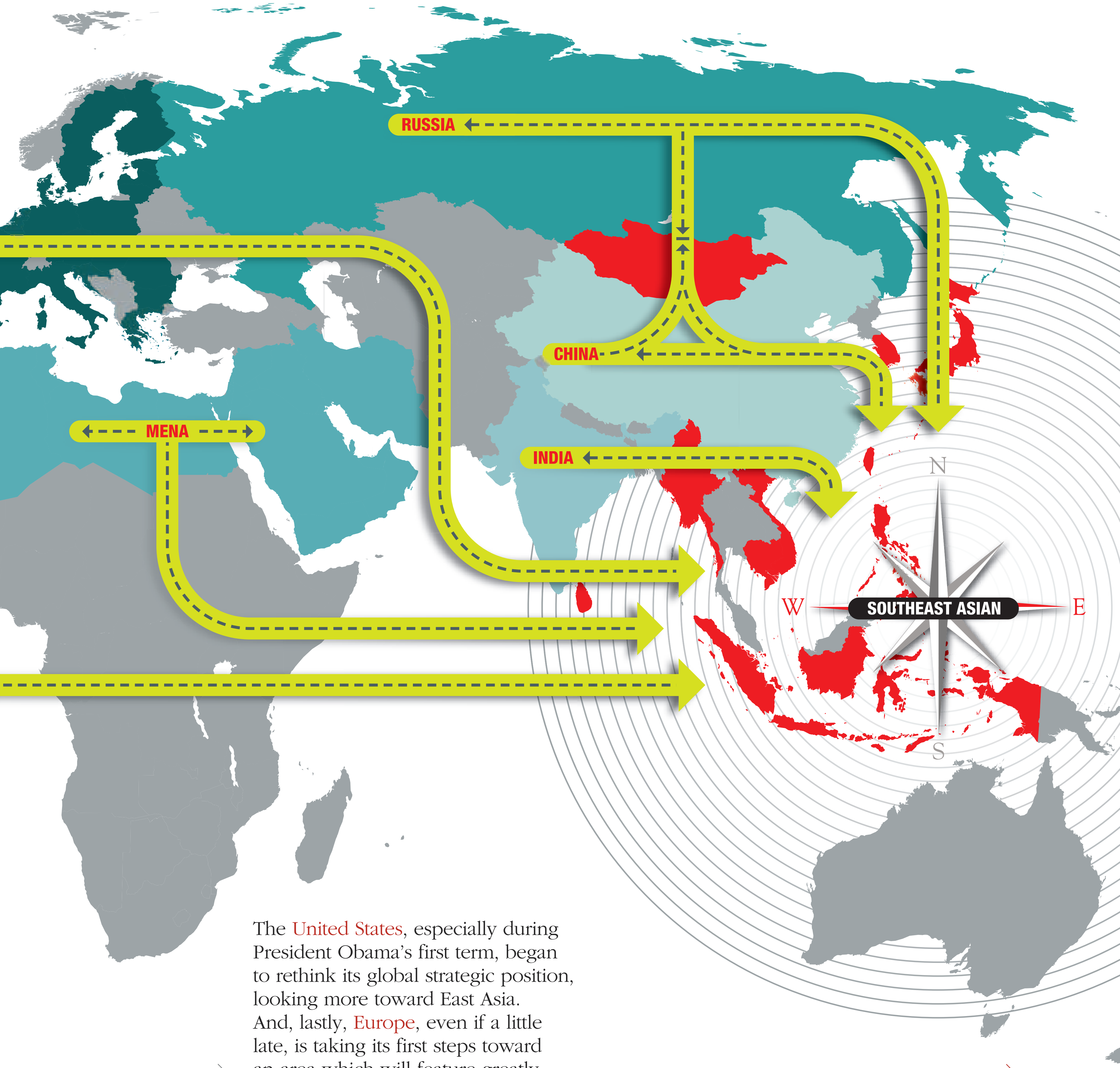
The center



Asia is a ray of light in the bleak landscape defined by the global economic crisis. The region has posted a constant increase in average annual GDP growth rates of between 5 and 8 percent. In the shadow of giants like China and India, the so-called Southeast Asian tigers have continued without a fuss and unabated to achieve economic vitality. From the point of view of energy production, the discovery of huge offshore reserves of gas and oil in various countries in the area offers a great opportunity for development. With regard to demand, the economic growth of Southeast Asian countries will bring about an increase in requirements and therefore a growing dependency on oil-producing countries.

The economic vitality and strategic position of the ASEAN countries has generated a growing interest in the area by global powers. China, with its geographical proximity, aims to extend its influence over the countries bordering the China Sea and secure its rich energy resources. Russia is not going to stand by and watch: for years it has increased its economic presence in the region.

of the future



The United States, especially during President Obama's first term, began to rethink its global strategic position, looking more toward East Asia. And, lastly, Europe, even if a little late, is taking its first steps toward an area which will feature greatly in the storyline of the 21st century.

Scenario/The President of the Royal Institute of East-West Strategic Studies in London explains the new global balance of energy

A new Eastern horizon

Growing numbers of agreements and partnerships are shifting the center of gravity of global growth towards the East, with China playing an increasingly pivotal role

by GRANT SUMMER

During the turbulent period of the recession, which affected the entire global community, some countries were better able to weather the storm due to the intense entrepreneurial drive and dynamism of their businesses, including in the energy sector. The common denominator among these more successful countries is their location in the eastern hemisphere. With China in the lead, they are now making vigorous efforts to grab oil and gas in the main global markets, so as to meet the growing demand for energy. This has led to a redrawing of the map of global growth, with repercussions for stability in a number of "hot" areas, including the Middle East. Jean-Christophe Iseux von Pfetten, President of the Royal Institute of East-West Strategic Studies in London, is one of the main observers of the new global economic and energy equilibrium and an expert in Beijing's trade expansion policies.

The crisis has shifted the axis of global development from the West towards Asia, which has seen record levels of growth. In your view, what effect is this having on the current global economic and political equilibrium?

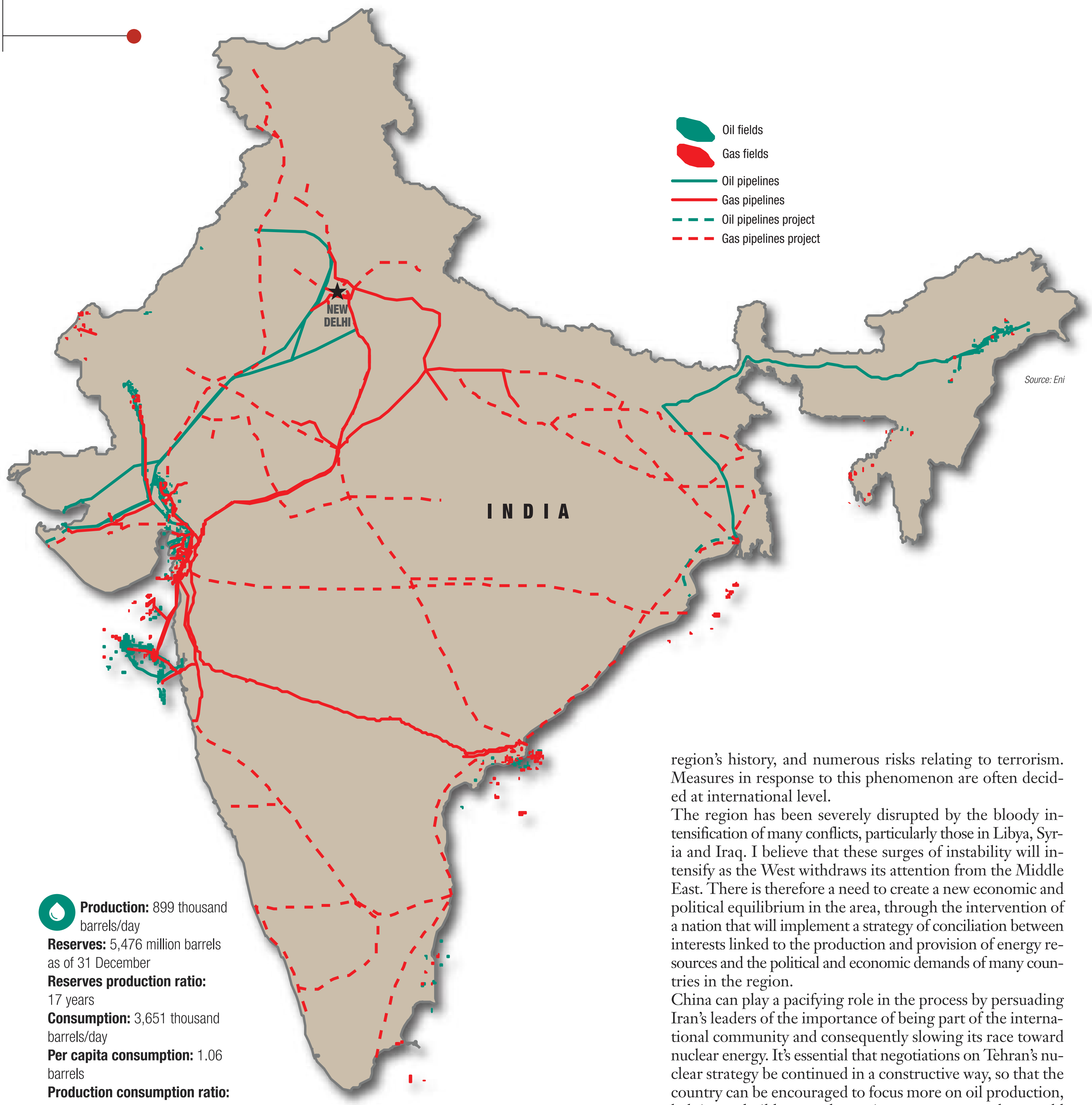
The first consequence of this imbalance is exponential growth in the energy requirements of major powers such as China and India. Beijing's need for oil, in particular, is in-

JEAN-CHRISTOPHE ISEUX VON PFETTEN
Jean-Christophe Iseux von Pfetten is the newly appointed President of the Royal Institute for East-West Strategic Studies in London and Visiting Professor at the Research Institute of World Economy, People's University of China (the latter since 2006). He is well known as the first non-Chinese member of a Chinese parliamentary institution (CPPCC 2001-2005). He is China's advisor to a number of Fortune 500 companies and currently holds non-executive positions on the boards of seven companies. In China, he is an honorary advisor to several governmental institutions.

creasingly pressing, and the same applies to many other natural resources. Broadly speaking, all of Asia (with China still the principal driving force) is eyeing with interest those countries that are long-time exporters of oil and other energy generation sources, particularly those of the Middle East, Africa, and (to a lesser extent) South America, with a view to securing more supplies.

The Middle East still tops the list, however. For a long time, the western countries dictated the rules of the game in this region. The Middle East was the realm of the big oil companies, such as BP, Shell and ExxonMobil, which controlled its oil production. While it is true that OPEC has intervened in many countries, I believe that the status quo could change very rapidly. The waning commitment shown by the U.S. to its own involvement in the Middle East also suggests this. The U.S. now benefits from shale gas and is no longer obliged to tie 100 percent of its energy production to Middle Eastern gas and oil. This has loosened its grip on the five big producers in the southern region of the Middle East. Meanwhile, China is moving rapidly, stepping up talks and signing up to agreements and projects: Sinopec, for example, has launched a major downstream oil project in the area, and has opened a channel for dialogue with Aramco in Saudi Arabia.

This is also the reason why China and other Asian countries have been forging diplomatic relations with countries like Iran that are oil- and gas-rich but not particularly accommodating. The primary reason for China's strengthening of its ties with Tehran is the security of its energy supplies. This was also →



Production: 899 thousand barrels/day
Reserves: 5,476 million barrels as of 31 December
Reserves production ratio: 17 years
Consumption: 3,651 thousand barrels/day
Per capita consumption: 1.06 barrels
Production consumption ratio: 0.25
Imports: 4,157 thousand barrels day (2012)
Exports: 1,469 thousand barrels day (2012)

Production: 39.94 billion cubic metres
Reserves: 1,340 billion cubic metres as of 31 December
Reserves production ratio: 34 years
Consumption: 55.97 billion cubic metres
Per capita consumption: 44 cubic metres
Production consumption ratio: 0.71
Import: 16.80 billion cubic metres

Source: Eni World Oil and Gas Review 2013

the rationale behind its recent agreement with Russia for the provision of gas. In my opinion, this trend will probably continue as new geopolitical relationships are established, such as Moscow's broadening of the scope of its commercial operations from Europe towards Asia. This could represent a turning point for all the rich gas- and oil-producing countries, which will gradually redirect their attention from the West toward the East.

Could this new horizon have repercussions in the Middle East? How could the balance of power change?

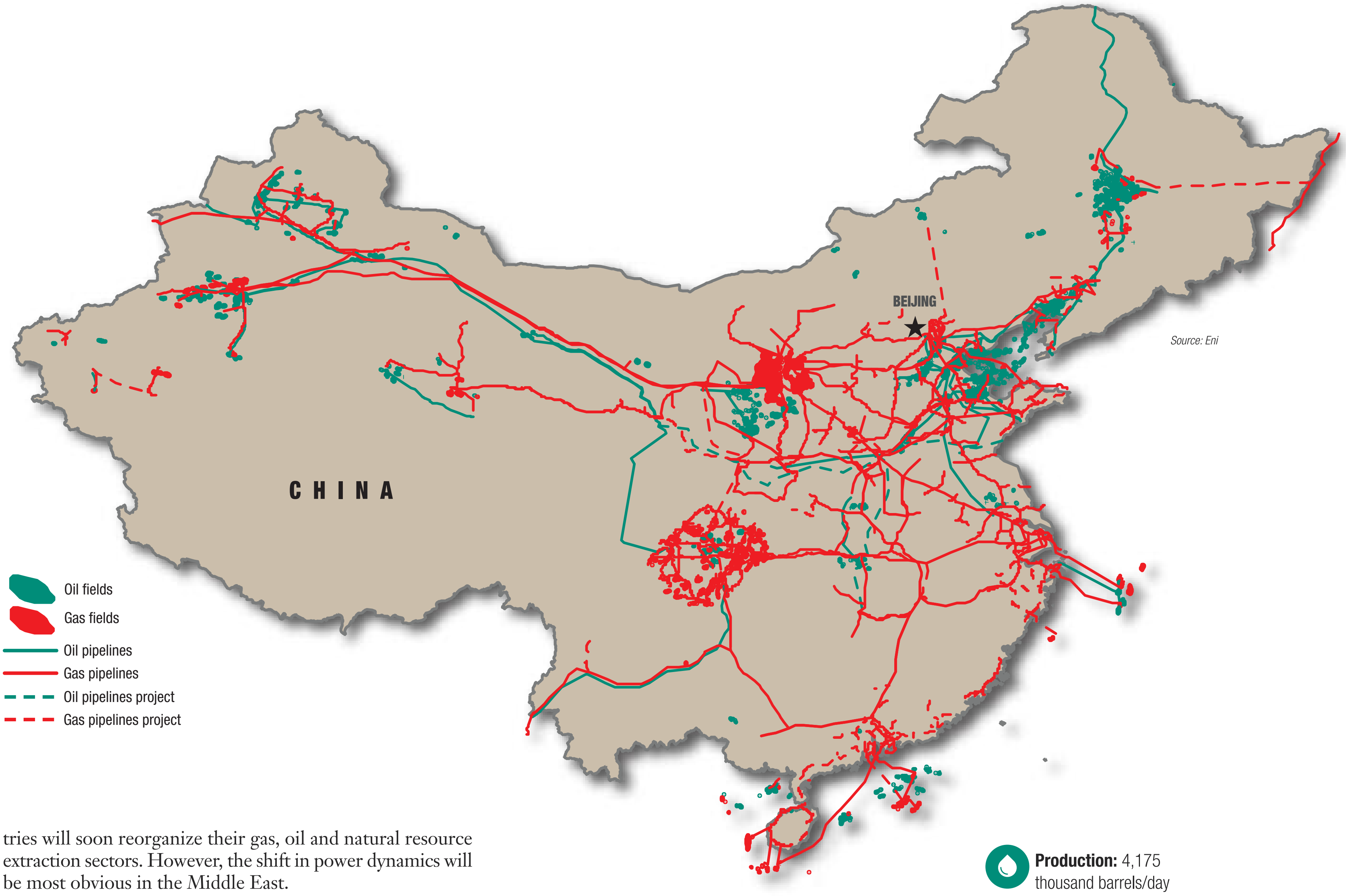
Asia's new focus on the Middle Eastern countries and the gradual waning of interest in the West will lead, in my opinion, to an unbalanced situation with repercussions for diplomatic relations within the region. This at a time when the situation in the Middle East is extremely complex, with tense relations between Shiites and Sunnis, clashes with roots in the region's history, and numerous risks relating to terrorism. Measures in response to this phenomenon are often decided at international level.

The region has been severely disrupted by the bloody intensification of many conflicts, particularly those in Libya, Syria and Iraq. I believe that these surges of instability will intensify as the West withdraws its attention from the Middle East. There is therefore a need to create a new economic and political equilibrium in the area, through the intervention of a nation that will implement a strategy of conciliation between interests linked to the production and provision of energy resources and the political and economic demands of many countries in the region.

China can play a pacifying role in the process by persuading Iran's leaders of the importance of being part of the international community and consequently slowing its race toward nuclear energy. It's essential that negotiations on Tehran's nuclear strategy be continued in a constructive way, so that the country can be encouraged to focus more on oil production, helping to build up an alternative energy source that would benefit the Sunni community in the south of the country. In the desirable event that the balance of power between Shiites and Sunnis in the Middle East can be restored, the Shiites could be supported by the East (China), and the Sunnis by the West. This would allow a more sustainable (relative) peace to be established in the Middle East.

China's gravitational force not only involves the Middle East, it seems, but also extends to other areas of the world.

Absolutely. Another consequence of the advance of the Asian countries, led by China, does not relate specifically to energy, but to natural resources more generally. In the last decade, Africa and South America have become have become a significant new sphere of influence for the big Chinese players. China Minmetals Corporation, for example, operates throughout South America and Africa, where it mines copper and many other metals, and also extracts gas and oil. Sinopec has begun to play an important strategic and operational role in Angola and Nigeria. I predict that these coun-



tries will soon reorganize their gas, oil and natural resource extraction sectors. However, the shift in power dynamics will be most obvious in the Middle East.

In this general readjustment of the global energy scenario, is the development of shale gas in China a realistic prospect?

The shale gas debate is still very interesting. I sit on the Advisory Board of CoPower, the largest private oil company in China. The government has authorized this company, as well as fellow oil company Shaanxi, to explore for and produce shale gas in basins mainly located in Mongolia and the province of Gansu, further to the west. If all goes according to plan, this production branch could become a major opportunity for China for several reasons. First, such developments would lead China to become less energy dependent, as has occurred in the United States. Second, this energy revolution would create new development in the western areas of the country, where growth is still stagnant. Most of the shale gas basins are located in western China, and could provide a positive economic stimulus in these areas.

How do you assess the geopolitical consequences of Russia's recent agreement to provide gas to China for 30 years?

The repercussions are unavoidable. The Chinese spent ten years negotiating the agreement. This is hardly a surprise move. They finally identified the right moment to reach an agreement, with Russia substantially lowering its expectations.
At this point, the Chinese accepted the terms of an agreement that, in my opinion, does not go beyond the strictly commercial prerogative of the understanding. I do not see the deal as the prelude to a new political and strategic alignment. I actually think that the two countries will maintain a mutually safe distance. But if we really want to look at the situation from a political and economic point of view, we can see that Russia is more interested in loosening its ties with the West, and is opening a channel for dialogue and exchange with the East. This reaction is partly the result of the dramatic events in Ukraine and Crimea in recent months.
I can understand that Russia might need to create new routes for development toward Asia, given the opportunities that are emerging there. It is worth remembering that Russia is not a "completely" western country. It is a nation divided into two, and the eastern part is still substantial. Russia's background is of a sharp division between east and west, which has led to a natural and understandable urge to sometimes lend a hand to the West, and sometimes to the East.
I predict – and I have said so several times – that Russia will not only look more often toward the East, but I presume that much of the Middle East and other countries will turn their backs on the West and also look toward Asia.

China and India have high energy requirements. Do you see any possibility of a partnership or shared project between these two countries?

Absolutely, yes. I think that China and India are two giants with many shared objectives, and they are highly complementary. In the high tech field, for example, the Chinese are working a great deal on hardware, and the Indians on software. There have already been numerous collaborations between Bangalore, Hangzhou and Zhejiang, for example. IT devices are produced in Fujian or Hangzhou, and the software comes from Bangalore. I believe that this type of partnership could extend into other areas. However, I don't believe a strategy of cooperation between the countries will developed in every area. I think this would be impossible, given that there is a long history of border disputes that still persist today. So I would say collaboration, but limited in the long term.

Production: 4,175 thousand barrels/day
Reserves: 25,585 million barrels as of 31 December
Reserves production ratio: 17 years
Consumption: 9,600 thousand barrels/day
Per capita consumption: 2.59 barrels
Production consumption ratio: 0.44
Imports: 6,441 thousand barrels day (2012)
Exports: 608 thousand barrels day (2012)

Production: 107.01 billion cubic metres
Reserves: 3,200 billion cubic metres as of 31 December
Reserves production ratio: 30 years
Consumption: 141.87 billion cubic metres
Per capita consumption: 105 cubic metres
Production consumption ratio: 0.75
Import: 38.34 billion cubic metres
Exports: 2.85 billion cubic metres

Source: Eni World Oil and Gas Review 2013

Analysis/ASEAN countries' net imports of oil will triple by 2035

The race towards Southeast Asian energy

The region has potentially vast reserves, but their exploitation poses a series of difficulties at both technical and political levels. The fields are located in areas that are disputed by various countries or are difficult to access

by KEVIN DOYLE

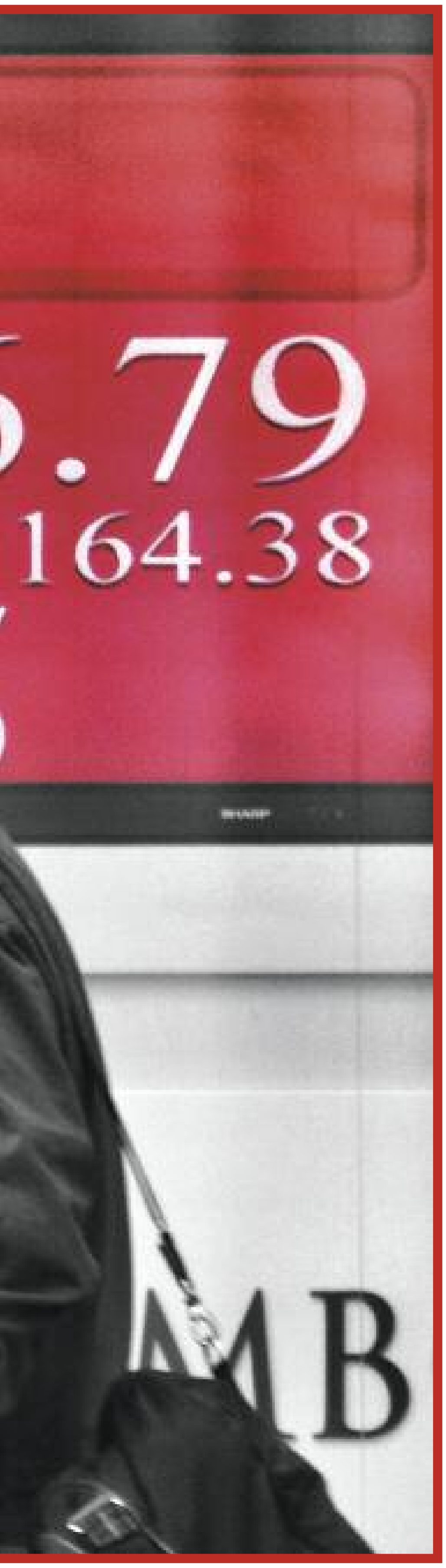
Sheltering from a tropical rainstorm in the steamy jungles of Sumatra 134 years ago, Aeilko Jans Zijlker, a Dutchman, asked an Indonesian plantation worker a fateful question. The answer would lead to the birth of one of the world's largest petroleum companies, and propel Indonesia to the position of one of the world's leading oil producers. On that rainy day in 1880, however, Zijlker could not have known that the luminescent flame from the rudimentary torch held by the plantation worker in the gloom of a monsoon downpour would, one day, give rise to Royal Dutch Shell Plc. From that question about a single flame, an empire would emerge.

For as long as anyone could remember, Zijlker was told, the inhabitants of that corner of Sumatra had fueled their bamboo torches and caulked their boats with an oozing black liquid scooped from the surface of pools that seeped to the surface of the marshy jungle. Guided to the area, Zijlker didn't need a geologist to tell him what he had stumbled upon: His nose alone was enough to identify the heady fumes of petroleum. The rest is history. In 1885, the first commercial reserves would be found at the Telaga Tunggal No.1 oil field, becoming the world's largest discovery of oil prior to World War II.

Indonesia was, in 1962, an early member of the Organization of Petroleum Exporting Countries (OPEC). In recent years, however, the country's oil sector has not faired so well. Suspending its OPEC membership in 2009, Indonesia had become a net importer of oil amid ever-rising domestic demand. Indonesia is not alone in its thirst for oil and energy in Southeast Asia. Across the region, demand for oil is booming as economies grow, populations increase, and modes of transport and lifestyle become more sophisticated. "The ten members of the Association of Southeast Asian Nations (ASEAN) are – along with China and India – shifting the centre of gravity of the global energy system to Asia," the International Energy Agency (IEA) stated bluntly in the first lines of its Southeast Asia Energy Outlook Report 2013.

ASEAN WILL BE THE FOURTH LARGEST GLOBAL IMPORTER OF OIL

Energy statistics in the IEA report should raise eyebrows. For example, since 1990, Southeast Asia energy demand has grown two-and-half times and is projected to grow, for the region's population of 600 million people, at least a further 80 percent by 2035 – an amount equal to the emergence of a second Japan and its power-hungry population. According to the IEA, by 2035, ASEAN (which is made up of 10 member states: Indonesia, Singapore, Thailand, Malaysia, Philippines, Brunei, Vietnam, Myanmar, Cambodia, and Laos) will see its combined economy triple in size and its popu-



lation rise by a quarter. During the same period, demand for oil will increase from 4.4 mb/d currently to 6.8 mb/d in 2035 – accounting for one-fifth of expected global growth in oil consumption. Natural gas use will increase by 80 percent, the need for coal will triple, and ASEAN'S electricity generation will increase by more than what India currently produces today.

All of this is putting Southeast Asia on track to be "the world's fourth-largest oil importer, behind China, India and the European Union," according to the IEA. In dollar figures, Southeast Asia's "net oil imports triple to almost $240 billion in 2035," according to the IEA outlook.

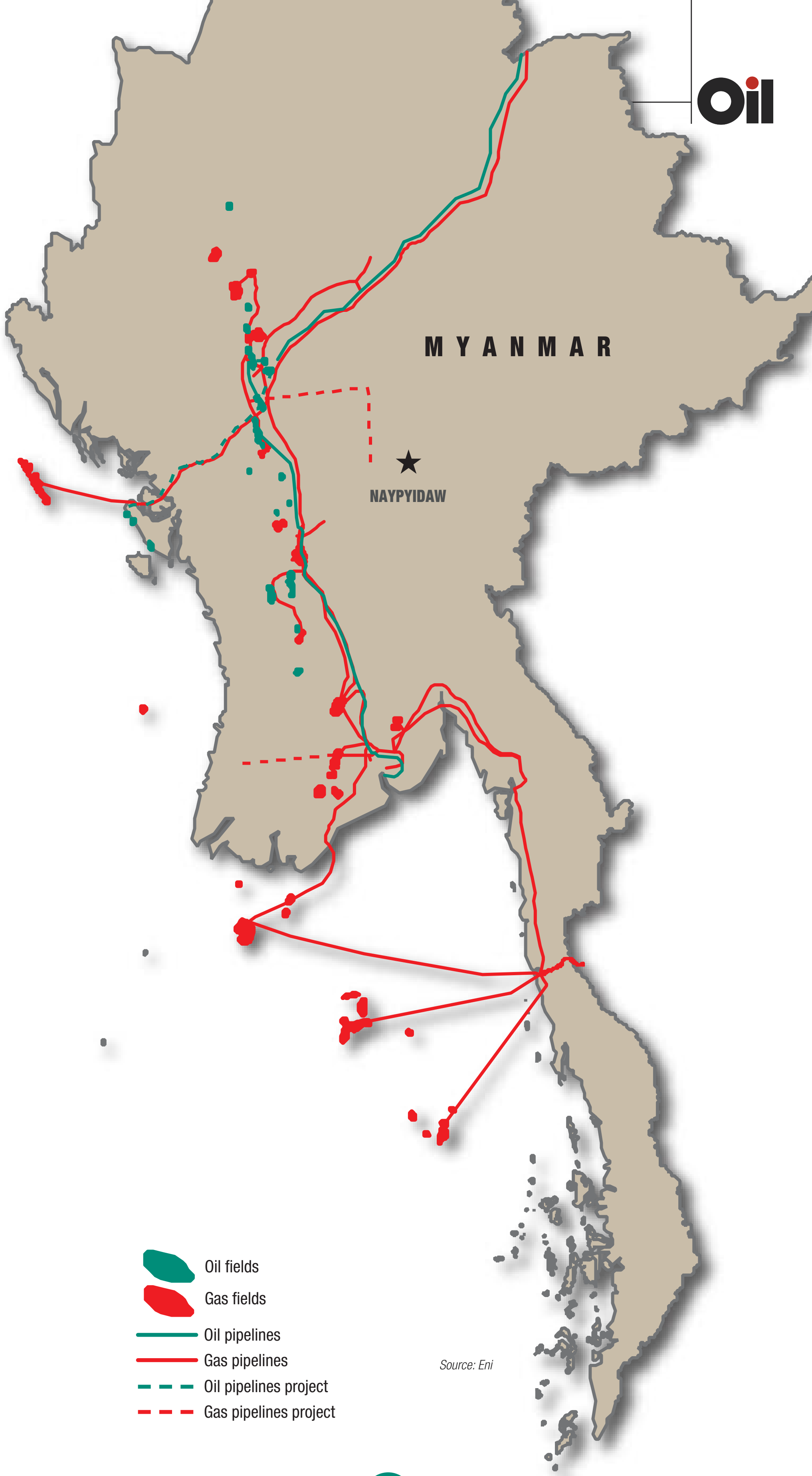
Excluding Brunei and Malaysia, Southeast Asia has become a net importer of oil since the mid-1990s. The region's potential to increase production to help meet its increased demand is possible, though it won't be easy. According to the IEA, Southeast Asia's proven reserves amount to 13 billion barrels, which will sustain output, at ongoing productions rates, to the late 2020s. But that is far from enough in a booming region. "There is still potential to boost output, as there remain relatively unexplored areas that are thought to hold significant resources particularly in deepwater," the IEA notes. Tapping new reserves, however, will require, alongside deepwater exploration and extraction in frontier and harder-to-reach reserves, political accommodation and cooperation as much, if not more, than platforms and drilling, experts say.

CAMBODIA, AN OIL TREASURE AS YET UNTAPPED

Cambodia is one of those countries with oil reserves that remain unexploited; its potential windfall is located beneath the turquoise sea off its sand beach and mangrove-fringed coast. In those waters, a modest treasure in oil remains untapped for one of the poorest countries in Southeast Asia. Unlike almost every other ASEAN country, Cambodia, a country of 14 million people with an economy that has modestly out-performed many of its neighbors over the past decade, has not tapped its oil reserves.

Owing to a mixture of ability-gap at the top tiers of government, the inefficiency of a corruption-plagued economy and complex geology, almost ten years have passed since Chevron expressed serious interest in working with the Phnom Penh government to get production moving. Chevron began exploring for oil off the coast of Cambodia in 2002. "That year, the Royal Government of Cambodia awarded Chevron Overseas Petroleum (Cambodia) Limited, a concession for offshore exploration and production. Since that time, Chevron has drilled 18 wells and acquired 3-D seismic data across more than 950 square miles (2,640 sq km)," according to Chevron.

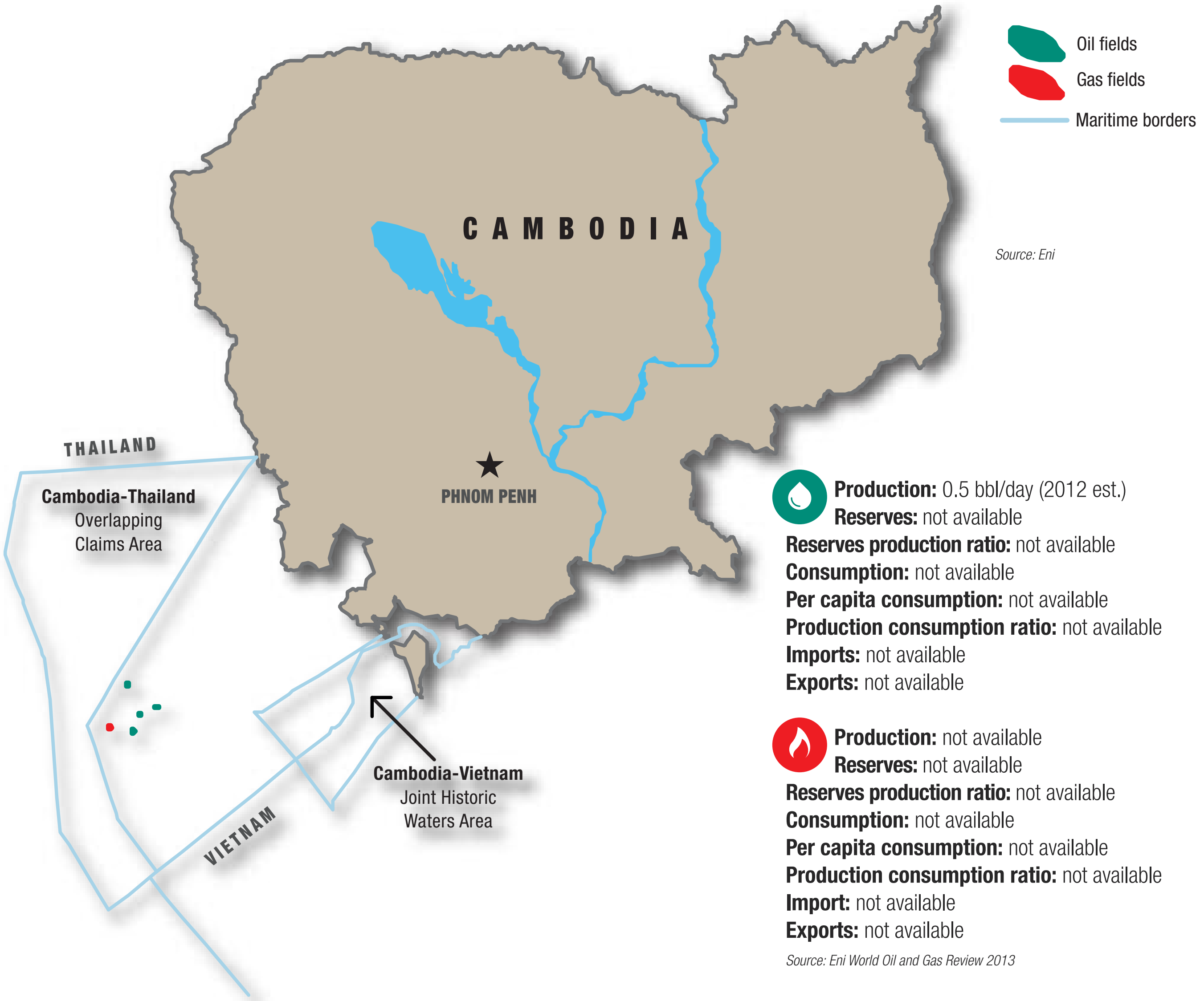
Three years later, in 2005, it was announced that potentially sizeable reserves had been identified under coastal Cambodia's seabed. However, despite much publicity and populist speculation by political figures, progress toward extraction has been bogged down in a dispute over taxation and the profit-share between the U.S. firm and the government of Prime Minister Hun Sen. According to the Cambodian National Petroleum Authority (CNPA), Cambodia's oil exploration territory is divided into six offshore blocs (A to F), 19 onshore blocs (I to XIX), and four areas located in what is known as the Overlapping Claims Area (OCA) in the disputed maritime border between Thailand and Cambodia. Though Chevron Overseas Petroleum (Cambodia) Limited "operates and has a 30 percent interest in Cambodia's offshore Block A, an area covering 1.2 million acres (4,709 sq km) in the Gulf of Thailand," as the company states →



Production: 17 thousand barrels/day
Reserves: 50 million barrels as of 31 December
Reserves production ratio: 8 years
Consumption: 29 thousand barrels/day
Per capita consumption: 0.17 barrels
Production consumption ratio: 0.59
Imports: 5 thousand barrels day (2012)
Exports: not available

Production: 11.92 billion cubic metres
Reserves: 509 billion cubic metres as of 31 December
Reserves production ratio: 43 years
Consumption: 1.77 billion cubic metres
Per capita consumption: 105 cubic metres
Production consumption ratio: 6.73
Import: not available
Exports: 10.18 billion cubic metres

Source: Eni World Oil and Gas Review 2013



Production: 0.5 bbl/day (2012 est.)
Reserves: not available
Reserves production ratio: not available
Consumption: not available
Per capita consumption: not available
Production consumption ratio: not available
Imports: not available
Exports: not available

Production: not available
Reserves: not available
Reserves production ratio: not available
Consumption: not available
Per capita consumption: not available
Production consumption ratio: not available
Import: not available
Exports: not available

Source: Eni World Oil and Gas Review 2013

on its website; it was still, in 2013, in “discussions concerning the production permit for development of Block A.”

THE AGREEMENT ON BLOCK A IS STILL FAR OFF

“A final investment decision to begin development will be considered after an agreement on commercial terms and government approval of production are in place,” Chevron says. That “agreement on commercial terms” remains elusive for Chevron to this day. Recent political developments in Cambodia may signal a breakthrough, particularly the restructuring of the powerful petroleum governing authority – the CNPA.

Michael McWalter, an Asia-Pacific energy expert and adviser on the petroleum sector to the Cambodian government, hailed the reintegration of the CNPA - previously a largely autonomous body - back into the Ministry of Mines and Energy, as a first step toward a long-sought deal with Chevron. While a timetable is not yet in place, a deal between Cambodia and Chevron is likely not far off, Mr. McWalter believes. By international, even regional, standards, the estimated reserves are modest. But, for a small country such as Cambodia, it would amount to a tidy revenue stream.

The difficulty in sealing the deal has resulted from Chevron’s inability to reach an agreement that would make it financially profitable to begin production, as the known reserves are difficult to extract, Mr. McWalter said, requiring horizontal drilling and other technically-challenging and time intensive processes. “Chevron’s development plan was submitted to the Government three-and-a-half years ago…. The government has not been able to approve that because of the ambivalence of the applicable fiscal and commercial terms, and unfortunately, this would not have been a problem were it a massive discovery. But, with the marginality of the discoveries and the nature of the geology - where you have lots of small fault blocks that you have to test one by one - it means they could just not get started. It just wasn’t profitable to commence production,” Mr. McWalter said in an interview.

“Now that the Petroleum Authority has been absorbed back into the Ministry of Mines and Energy, the government is reconsidering its petroleum framework and getting its house in order within the revamped ministry and they are reconsidering their terms for oil development. They realize that if they are going to have oil production, it has got to have an element of commerciality for the investor,” he said.

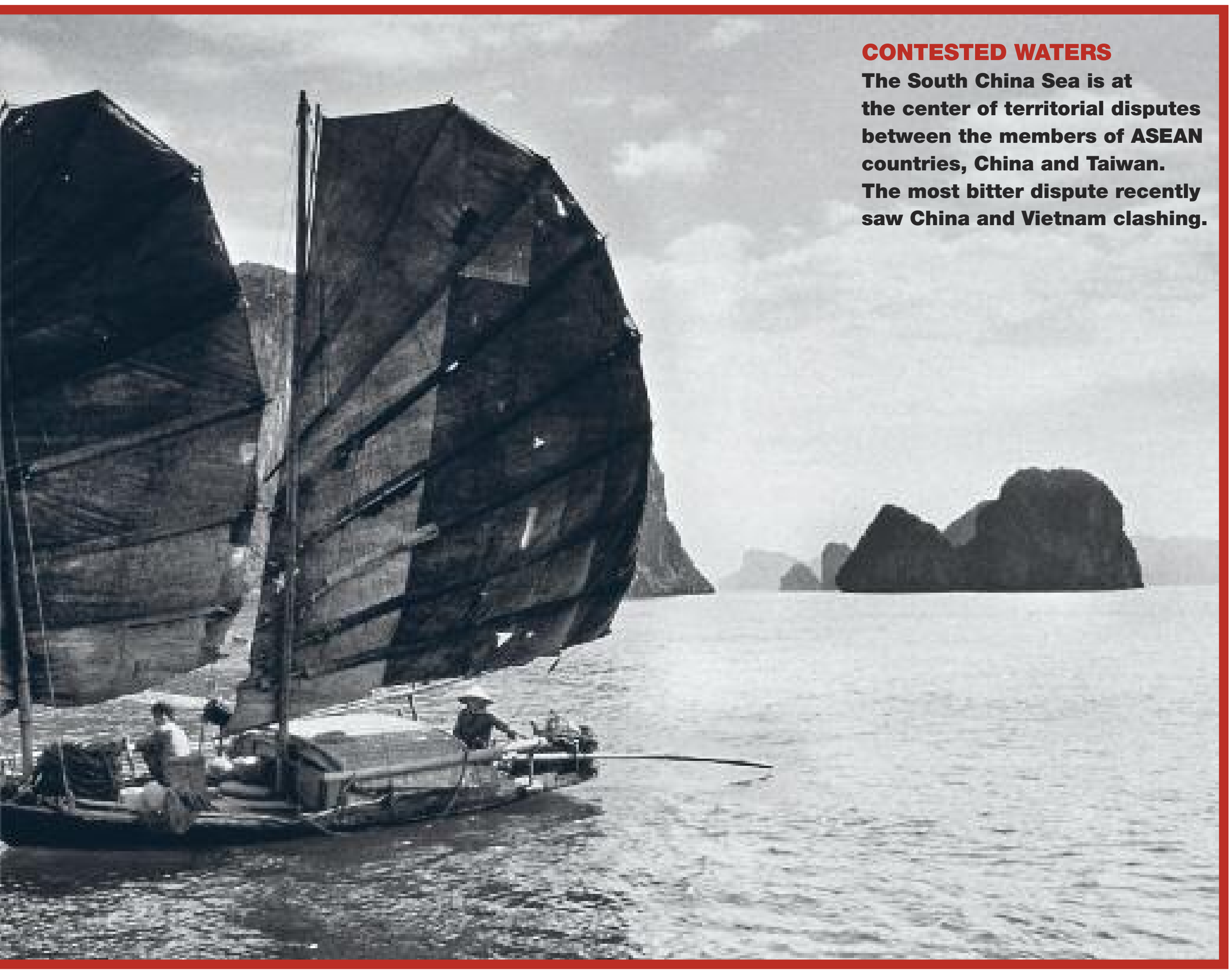
“Once the Government does get it sorted out, hopefully Chevron would start with a single platform, small-scale production, probably around 5,000 to 6,000 barrels a day. Then they will add three more platforms to see how they go and then add a further six more platforms and hopefully bring production up to around about 25,000 barrels a day. The current plans target 25,000 barrels after several years of production start-up; so you won’t see 25,000 barrels a day from the start, it will creep up.”

> By international standards, Cambodia’s estimated known reserves of oil are modest. But, for a small country, it would amount to a tidy revenue stream

There is one potential bright side to the decade of delay. Though frustrating, it might even have played to Cambodia’s advantage by allowing the country time to develop a more mature approach to the handling of oil reserves and revenues, Mr. McWalter believes. “Despite the delay, Cambodia has not lost its oil. The oil is still there. The Government has had the benefit of various technical assistance programmes, with the Asian Development Bank, World Bank, Norwegian Government. They’ve learned a lot and they are better positioned now to make a decision as to how they want to work it. And, of course, oil hasn’t gone down in price anyway.”

The best-case scenario, Mr. McWalter said, is for the Chevron development plan to be re-filed for consideration next year with the Cambodian government, and work to begin a year later. “I would imagine we could see possibly a re-filing of the development plan sometime in the next year, maybe by 2015 September time. The government hasn’t said anything yet…but it is what I could imagine: a re-filing, and reconsideration of the development plan for a start-up of work on the development plan in 2016.” This scenario could mean oil coming online by 2019 or 2020, according to Mr. McWalter.

Cambodian officials, whose political



CONTESTED WATERS
The South China Sea is at the center of territorial disputes between the members of ASEAN countries, China and Taiwan. The most bitter dispute recently saw China and Vietnam clashing.

THE AUTHOR. Based in Southeast Asia for almost two decades, Kevin Doyle has worked for Reuters news agency and TIME Asia magazine. Most recently he was editor-in-chief of the Cambodia Daily newspaper in Phnom Penh from 2004 to 2014. A Nieman Fellow at Harvard 2010-2011, he is currently writing a book about contemporary Cambodian society and politics.

culture has yet to fully embrace ideals of transparency, declined to comment for this article. Cheap Sour, director-general of the General Department of Petroleum, and Men Den, Deputy General Director of Oil & Gas Resource Upstream Division, at the CNPA, declined to comment.

One well-placed source in Phnom Penh said this week that Cambodia's new Minister of Commerce, Sun Chanthol, had recently met with Chevron officials and that the U.S. oil company had reiterated that the "first drop" of oil could flow by 2018. But that, of course, depends on the long-discussed agreement being inked. In April, Mr. Chanthol asked Azerbaijan's help in developing Cambodia's oil and gas industry. The exact scope of that assistance is not yet known.

While much of the focus in Cambodian oil production is centered on Chevron's plans for Block A, the CNPA has been keen to push the potential for on-share reserves in the area know as the Tonle Sap basin – a giant lake in the north of the country. According to the CNPA's website: "Onshore exploration covers 19 Blocks, of which three Blocks (12, 15 and 17) are currently awarded to international oil companies for exploration and prospect study (prospecting license)."

THE OCA AGREEMENT WITH THAILAND

Another area of potentially vast reserves lies beneath the contested waters of the Thai-Cambodia maritime border, better known as the Overlapping Claims Area (OCA), which covers some 27,000 km2. One estimate says the area could contain up to 11 trillion cubic feet of natural gas and an undetermined amount of oil. According to the CNPA, a memorandum between Cambodia and Thailand pertaining to joint management of resources in the OCA was signed in 2001, only to be shelved by Thailand in 2009 amid political turmoil in Bangkok.

Without a meeting of the minds on how to share the bounty of the OCA, neither country will be able to tap the area's full potential. Mr. McWalter, however, is still optimistic about an eventual settlement in the OCA that could be to Cambodia's advantage. He believes Cambodia is now in a better position than before to benefit from an agreement over the OCA – though Thailand has long dug in its heels on claiming the lion's share of the zone's potential bounty. "The benefit to Cambodia with time, of course, is that Cambodia is learning more and more about the petroleum industry…. In the downstream, for instance: Cambodia is planning to build a refinery with a consortium from China, which would be rated at 100,000 barrels per day… Now, if they can learn more about the upstream and nurture Chevron toward [Block A] development, and if they can nurture the downstream opportunities and set up some refining capacity, they are in a much better position to benefit from any future production arising from the Overlapping Claims Area," he said. "The longer that the Thais prevaricate, delay, and make things difficult for resolution of the OCA, the better it becomes for Cambodia, because it is quietly learning the tools →

Source: Eni

Production: 21 thousand barrels/day (2012)
Reserves: not available
Reserves production ratio: not available
Consumption: 2,268 thousand barrels/day (2012)
Per capita consumption: 17.04 barrels (2012)
Production consumption ratio: 0.01
Imports: 3,500 thousand barrels day (2012)
Exports: 1,198 thousand barrels day (2012)

Production: 0.47 billion cubic metres
Reserves: 1 billion cubic metres as of 31 December
Reserves production ratio: not available
Consumption: 53.65 billion cubic metres
Per capita consumption: 1,104 cubic metres
Production consumption ratio: 0.001
Import: 51.11 billion cubic metres
Exports: not available

Source: Eni World Oil and Gas Review 2013 of the trade and will put itself in a better position to make the bests of the opportunity of the sharing arrangements, whatever they may be, from the OCA."

"Whilst it would be nice to have it resolved, it would be nice to have it resolved at a time when Cambodia can optimize its receipt of crude oil; receipt of gas, and use of it in its own economy. Otherwise all the production will end up all being piped to the shores of Thailand and there would be no knock-on, spin-off benefits in the downstream utilization of those resources for Cambodia. So, I think, in a fortuitous way, time is on the side of Cambodia."

One of those downstream opportunities is a multi-billion dollar oil refinery planned for Cambodia's southern coast. Last October, Cambodia's Prime Minister Hun Sen urged Cai Xiyou, senior vice president of the China Petroleum and Chemical Corporation, or Sinopec, to speed up construction of the planned refinery, which is tentatively scheduled to open in 2018, according to The Cambodia Daily newspaper. Cambodia currently imports in the region of 1 million tons of oil each year, according to the paper, which noted that Sinopec was one of several Chinese firms, including Sinomach China Perfect Machinery Industry Corporation, to sign a memorandum of understanding on the construction of a refinery facility in Cambodia.

"The nature of the refinery plan is to bring from the Middle East heavy crudes and refine them in Cambodia and then bring them to the local market to the extent required in that rapidly growing market, and transport the excess to the investor's homeland – China," Mr. McWalter said. "[The refinery] has the capacity to be a nice project so long as the company has a good cheap crude source and there can be some appropriate off-take arrangements for the products [with] robust prices, and moreover it will provide security of supply of petroleum products in the Cambodia market," he said. "All those ingredients: the supply, the uptake; all have to be transparent and at proper prices, and with no meddling like subsidies. Otherwise, the economics could be distorted and there could be severe foreign exchange repercussions. So, it is fine, so long as one can make sure everything is appropriately priced and there are no special deals."

"I think the age for oil in Cambodia would start from 2020 onwards, for several decades onward. It would provide a tidy little income. It is not going to be large scale. It's not an Iraq or anything like that. But, 25,000 barrels a day would provide a nice export income into the economy and hopefully the Government would be able to obtain a reasonable split of the net value of production say 75 to 25 in favor of Cambodia.

Somewhat mirroring the travails of Cambodia and Thailand in the OCA, the wider Southeast Asia region – as thirsty as it is for energy – is also stymied by serious territorial disputes in the potentially petroleum- and gas-rich seabed of the South China Sea. The US Energy Information Administration states that it is "difficult to determine the amount of oil and natural gas in the South China Sea because of under-exploration and territorial disputes." However, the "EIA estimates there to be approximately 11 billion barrels (bbl) of oil reserves and 190 trillion cubic feet (Tcf) of natural gas reserves in the South China Sea."

VIETNAM: THE WATERS CONTESTED WITH CHINA

The EIA also notes that in November 2012, the "Chinese National Offshore Oil Company (CNOOC) estimated the area holds around 125 billion barrels of oil and 500 trillion cubic feet of natural gas in undiscovered resources, although independent studies have not confirmed this figure." With such potential, it is no surprise that the South China Sea is a hotbed of conflicting territorial claims between Asean members, China and Taiwan. None of those claims have become more heated or more dangerous in recent months than the current high-seas standoff between China and Vietnam over China's Haiyang Shiyou-981 oil rig, which was towed into waters long-claimed by Vietnam on May 1.

Since then, ships from both countries have rammed each other as Hanoi demands, and China refuses, removal of the giant oil rig, which Beijing claims it has placed within its expansive "nine-dash line" historic maritime territory. The challenge by Beijing comes as Vietnam's state oil firm, PetroVietnam, has pushed ahead with plans to increase oil production in the South China Sea – now known to the Vietnamese as the "East Sea" – with such partners as India's ONGC Videsh Limited, Russia's Gazprom, and ExxonMobil. As the US EIA points out: "In June 2012, CNOOC offered nine oil and gas blocks to foreign bidders in a part of the South China Sea overlapping with Vietnam's 200-mile exclusive economic zone in the Jiannan and Wan'an Basins. (...) The Vietnamese government disapproved of the offer, and no foreign firms have bid on blocks.

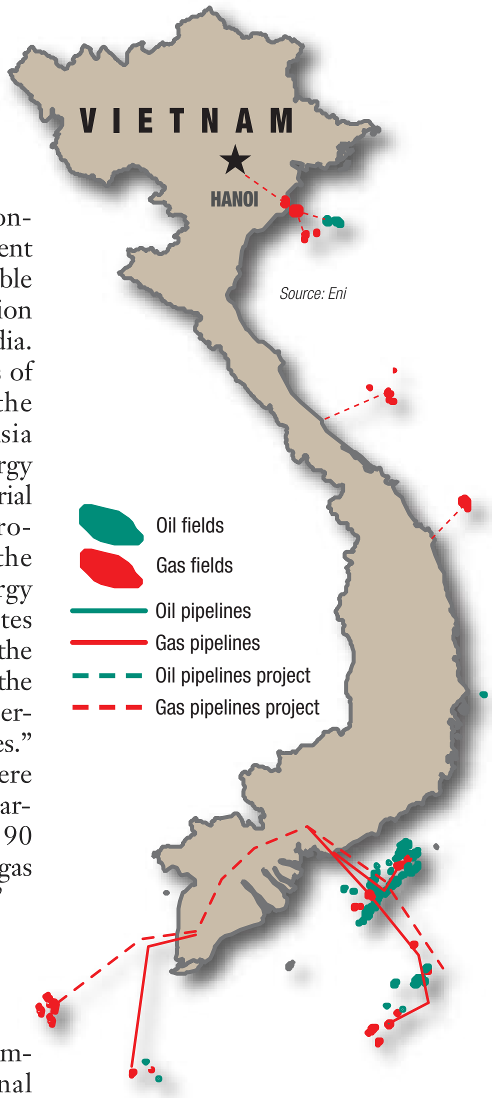
Carlyle A. Thayer, a Vietnam expert and emeritus professor at the University of New South Wales, said that prior to China unexpectedly moving the oil rig into Vietnam's economic zone, relations between Hanoi and Beijing had been on an upward trajectory. Beijing's move was "unexpected, provocative and illegal," according to Mr. Thayer.

"[It was] provocative because it wasn't just placing a rig there, it was placing warships and coastguard and everything else around it. That was a real challenge and China can't claim ignorance of Vietnam's Exclusive Economic Zone," Thayer said.

Vietnam decreed the drafting in 2007 of a Maritime development strategy 2015-2020 to integrate offshore maritime zones with coastal provinces, and the strategy envisioned that a very large proportion of Vietnam's GDP would come from those areas, Mr. Thayer explained. China, however, around 2009, began approaching Western oil companies to tell them their interests in China would suffer if they assisted Vietnam in its planned maritime developments, he said, adding that the U.S. administration called Beijing on the issue and China backed off.

"Vietnam is dead set on developing that maritime economy. It is energy short, they definitely need oil and gas, and that also motivates China. Therefore, that is why they [the Vietnam government] have been modernizing the navy and buying those kilo [class] submarines and getting shore-based ballistic missiles that can attack shipping. It's to create a defensive area so they can deter China," Mr. Thayer said.

Such disputes leave a large question mark hanging over the future of the resources of the South China Sea, at a time when the region needs energy more than ever. "Asia is building itself and is settling into more sophisticated living and there are still more people to be brought out of, if not poverty, near poverty," said Mr. McWalter, who advised the Cambodia government on the petroleum sector. "I can't see, really, the energy demand diminishing," he said. Whether the region's future supply of energy is through conflict or greater cooperation remains very much to be seen. ■



Production: 356 thousand barrels/day
Reserves: 4,400 million barrels as of 31 December
Reserves production ratio: 34 years
Consumption: 413 thousand barrels/day
Per capita consumption: 1.68 barrels
Production consumption ratio: 0.86
Imports: 291 thousand barrels day
Exports: 218 thousand barrels day

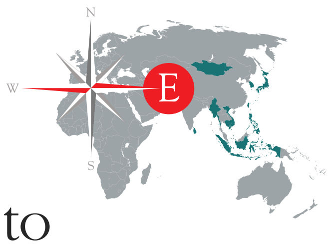
Production: 9.77 billion cubic metres
Reserves: 224 billion cubic metres as of 31 December
Reserves production ratio: 23 years
Consumption: 9.74 billion cubic metres
Per capita consumption: 108 cubic metres
Production consumption ratio: 1.00
Import: not available
Exports: not available

Source: Eni World Oil and Gas Review 2013

On www.abo.net, read other articles on the same topic by Yao Jin and from *Oil Book Vietnam*.

Indonesia/Foreign companies are discouraged by government protectionism

Resource nationalism is curbing investments



The objective, declared by both candidates in the elections, to increase the production of hydrocarbons, is actually secondary to that of guaranteeing greater "Indonesiazation" of the sector

by BEN BLAND

The list of major international oil and gas companies operating in Indonesia reads like a who's who of the industry, featuring the likes of BP, Chevron, ExxonMobil, PetroChina, Total and many more. Yet, after a long history of successful exploration and production in Southeast Asia's biggest economy, the industry is facing an ever-tougher investment climate.

The economic boom of the last decade in Indonesia has prompted a rising tide of resource nationalism, mirroring the trend in many other emerging markets from Brazil to Vietnam.

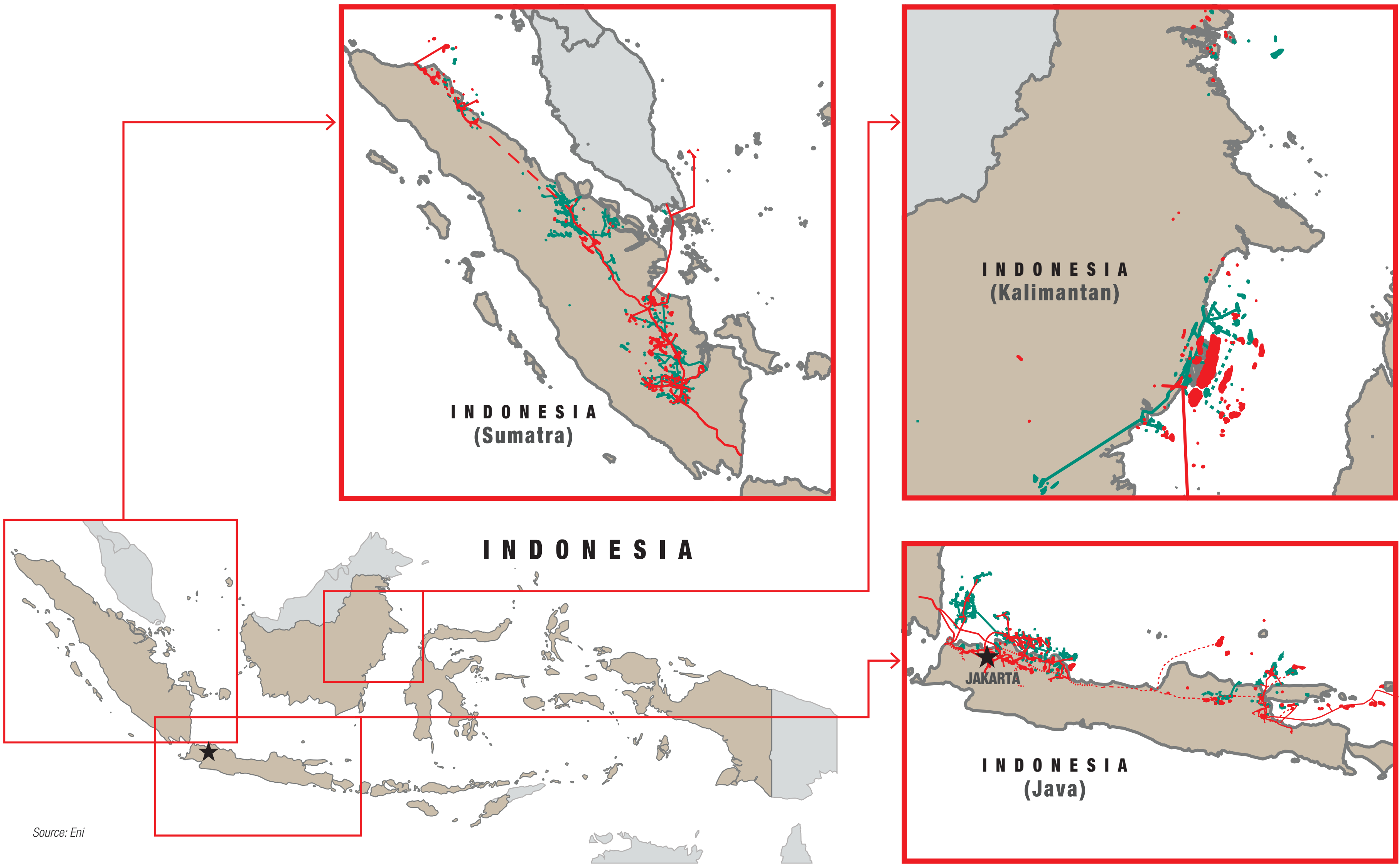
So as many of the country's long-established oil fields have been maturing, the investment climate for foreign companies has deteriorated progressively because of a raft of new restrictions and regulations.

Once a member of the Organization of the Petroleum Exporting Countries, Indonesia became a net importer in 2004 as its demand increased rapidly and production failed to keep pace.

THE CLIMATE FOR INVESTMENTS HAS DETERIORATED

This mis-match has accelerated in the last few years as Indonesia's generous fuel subsidies and thriving domestic →

THE AUTHOR. Ben Bland is the Jakarta-based Indonesia correspondent for the *Financial Times*. He has worked in Southeast Asia for six years and was previously based in Singapore and Vietnam. Prior to that, Ben was a business reporter in London for *The Daily Telegraph*, *Dow Jones Newswires* and the *Wall Street Journal*.



Source: Eni

economy have kept demand high at the same time as production has declined. That has put pressure on Indonesia's state finances, leading to a large current account deficit, and prompting calls from the government for an increase in production and dire warnings about the future outlook. "If we don't find new [oil] and start increasing production, in 12 years, our crude oil will be entirely depleted and we'll be entirely dependent on imports," said Prabowo Subianto, a former general and one of two candidates competing in Indonesia's landmark presidential election in July, in a speech to diplomats and journalists. "With gas we only have 32 years. The new administration must address these realities." Mr Subianto's rival to replace outgoing President Susilo Bambang Yudhoyono, Jakarta governor Joko Widodo, has made similarly stark comments about the need to revitalise Indonesia's oil and gas production. But, despite pledging to ease business permitting procedures, both men have indicated that they intend to stick with the economic protectionism that has increased under Mr Yudhoyono's watch.

That is bad news for international oil and gas companies, says Bill Sullivan, a lawyer specialising in the industry at Christian Teo Purwono & Partners in Jakarta, the Indonesian capital. "The policies that have discouraged further foreign investments in the oil and gas sector are resource nationalist in tone," he explains. "The leading candidates for the presidency both endorse resource nationalism so I expect it will continue to be the official policy of Indonesia, regardless of who the next President is and who they select for their cabinet when they take office in October."

HOW BAD IS THE PROBLEM?

The world's biggest archipelago nation, Indonesia has proven oil reserves of 3.6 billion barrels and is the world's 20th biggest oil producer, accounting for 1.1 percent of global production, according to PwC, the accounting and consulting group. The nation is the 10th biggest producer of gas, with proven reserves of 104 trillion cubic feet.

However, production of both resources has been declining steadily since 2010 and the situation is particularly acute in the case of oil. Oil production has fallen from one million barrels per day in 2010 to 826,000 barrels last year. This year, despite a lofty government target to return to the 1m level, PwC forecasts another drop to 798,000 barrels. Part of the problem is the maturation of existing oil fields and the fact that the most

> Indonesia has enormous potential in unconventional gas and oil: it holds the sixth largest estimated global reserves of coal-bed methane (453 trillion cubic feet)

easy-to-exploit oil reserves have already been tapped. At the same time, many international oil companies are reluctant to expand significantly their investments in Indonesia because of a wide range of concerns, from questions of contract sanctity to cumbersome regulations.

Indonesia's state-owned national oil company, Pertamina, says it is keen to fill the gap, but many analysts doubt whether it has the technical know-how and the risk appetite for deep water exploration or enhanced recovery techniques – two key ways to boost production. "The investment climate for oil and gas in Indonesia is getting incrementally tougher – exemplified by the multi-year trend of declining new exploration drilling," says Angus Graham, the head of strategy and research for Risco Energy, an energy investment company that is based in Jakarta. "New exploration drilling is the key litmus test of investment attractiveness and the logical prerequisite for reserves and subsequent production growth."

Mr Graham says that there is typically a time-lag of 6-10 years between successful "wildcat" drilling and new production coming on stream. With new exploration activity such a leading indicator, industry executives believe it is unlikely that Indonesia can buck the trend of declining oil production within the next few years, even if it moves to improve the investment climate immediately.

WHAT'S CAUSING THIS SITUATION?

For international investors in Indonesia, dealing with seemingly endless red tape and overlapping regulations from different ministries and the central and local governments are standard bugbears. But for oil and gas companies, the headaches have been steadily increasing in recent years as resource nationalism has been on the rise. One major problem relates to the complicated cost recovery system under which Indonesia operates most of its production sharing contracts

Production: 890,000 barrels/day
Reserves: 4,030 million barrels
as of December 31
Reserves/production ratio: 12 years
Consumption: 1,541,000 barrels/day
Per capita consumption: 2.30 barrels
Production/consumption ratio: 0.58
Imports: 291,000 barrels/day
Exports: 370,000 barrels/day

Production: 79.82 billion cubic meters
Reserves: 2,919 billion cubic meters
as of December 31
Reserves/production ratio: 37 years
Consumption: 41.14 billion cubic meters
Per capita consumption: 168 cubic meters
Production/consumption ratio: 1.94
Exports: 38.68 billion cubic meters

Source: Eni World Oil and Gas Review 2013

Oil fields
Gas fields
Oil pipelines
Gas pipelines
Oil pipelines project
Gas pipelines project

(PSCs). This structure, common in many countries, was designed to promote investment by allowing companies to claim back the costs of developing and operating successful projects from the government. The government, in exchange, receives a risk-free share of the production, once the costs have been paid off through the initial sales of oil and gas. Indonesia's upstream oil and gas regulator, known as SKKMigas, must approve all spending. Amid a growing clampdown on the country's endemic corruption, it scrutinises every single dollar of cost recovery.

"When you operate under a PSC in Indonesia, you are effectively a contractor spending government money," says Anthony Anderson, a technical adviser focusing on the resource industries at PwC in Jakarta. "Some executives spend more time navigating the approval process than strategising about how they can find more oil and gas."

The perils of making any mistakes in the process have been exposed at high cost for Chevron, Indonesia's biggest crude oil producer, which saw several of its Indonesian contractors and employees convicted of corruption last year in a controversial trial.

They were found guilty of failing to obtain proper permits for a project to remove toxic substances resulting from drilling on the resource-rich island of Sumatra which they had conducted. The prosecutors argued that Chevron's workers had breached Indonesia's tough anti-corruption law by causing state losses because the expenses of the clean-up program would eventually have been eligible for reimbursement under cost recovery. Chevron, evincing shock at the verdict, responded that there was "no actual evidence of any state loss or any illegal activity." The outcome has made many in the industry, and the regulator, extremely nervous about the cost recovery process.

The other main issues, according to Bill Sullivan, the Jakarta-based lawyer specializing in the energy sector are as follows: a new regulation restricting foreign investment in the upstream oil and gas services industry; increasing difficulties faced by producers that want to extend their PSCs; a clampdown on expatriate workers in oil and gas, in which many are refused visa extensions; and a total ban of all foreign staff over age 55. "Many Indonesians have convinced themselves that Indonesia doesn't need foreign investment in the resource sector," he says. "The reality is that despite the talk of wanting to increase oil and gas production, that's secondary to the goal of ensuring greater Indonesian-isation of the sector."

HOW DOES INDONESIA STACK UP AGAINST OTHER COUNTRIES?

Despite the deteriorating investment climate in Indonesia, the key question for industry executives is how the risk-reward calculus matches up against other countries competing for their investment dollars. Alas, Indonesia is perceived by oil and gas investors as one of the least attractive places to do business in Southeast Asia, says Mr Graham of Risco, even if it has more oil and gas companies in operation than any other country in the region and a 130-year history of production. And using a survey of 106 executives working at 90 oil and gas companies in Indonesia, PwC found that Indonesia was losing its competitive edge, lagging behind Australia, China, Malaysia, Norway, the United Arab Emirates and the United States. It remained more competitive than Angola, Nigeria and Venezuela in everything apart from geological prospects – not exactly a ringing endorsement given the problems plaguing these frontier markets.

The PwC survey also revealed that while 64 percent of respondents believed that their need for capital in Indonesia would increase in the next five years, 75 percent expected their investment appetite to decrease or stay the same – a situation that the advisory company described as a "red flag."

Meanwhile, the fiscal regime in Indonesia is also less attractive than that of many of its Asian neighbors, says Mr. Graham, although there is variation by the particular block and region of Indonesia. Oil contractors in Indonesia can only expect an average take of 16 percent, compared to 40 percent in the Philippines and Thailand and 35 percent in China and Mongolia. However, those operating gas projects, which have a much longer lead time, take 35 percent, and those producing in more remote East Indonesia take 33 percent.

WHAT ARE THE OPPORTUNITIES?

Despite the challenges, Indonesia's oil and gas sector does present opportunities. And while some investors, such as Hess and Anadarko, have pulled out of Indonesia as part of global strategic re-thinks, others are coming in. The higher shares of production on offer in East Indonesia are part of government attempts to drive new exploration in this large but hard-to-reach region, which is believed to have good drilling potential.Still, exploring the deep waters of Indonesia is expensive and, even if successful, the costs of producing and shipping oil and gas in the distant waters around Papua, Maluku and Sulawesi will be high.

> If the country wishes to succeed in upgrading its production of oil and gas, it should reverse the trend of economic nationalism and simplify the bureaucracy

Some existing oil and gas operators in Indonesia have the potential to increase their production through enhanced recovery techniques. But uncertainty over the renewal of the PSCs is deterring many from stepping up their investments. France's Total offers the most obvious case, with the company warning that it will curb spending at its Mahakam block in East Kalimantan unless the government agrees to extend its PSC beyond the 2017 expiration deadline. With Pertamina repeatedly saying it wants to take over the block, the government has not been willing to reach any agreement with Total.

"Established investors in Indonesia want to spend billions of dollars on their blocks but there's no point if they won't get an extension as they can't earn a return on their investment," says Mr Anderson of PwC.

Indonesia also has great potential for unconventional oil gas, with the world's sixth largest estimated reserves of coal-bed methane (453 trillion cubic feet) and 574 trillion cubic feet of estimated shale gas reserves. But it is very early days, with the first four pilot CBM projects selling their first gas last year and the first shale gas proposals still at the study phase.

THE OUTLOOK

Whether through new oil and gas discoveries, enhanced recovery at existing wells or unconventional sources, Indonesia will have to reverse the trend of economic nationalism and start simplifying bureaucratic procedures if they are to succeed in boosting production. Even then, it will take time for increased investment to feed into expanded production.

The question for international oil and gas companies looking at Indonesia is whether the government will improve the investment climate. Mr. Sullivan is not optimistic about the prospects of a shift in Indonesia's political discourse away from "Indonesian-isation." But he believes that the appointment of more competent officials by the next government would help to make incremental change.

"If we had a more technically competent and industry-experienced figure as the minster of energy and mineral resources, there's a lot that that person could do to blunt some of the more egregious regulatory developments in the oil and gas sector and make things a bit better for companies," he says.

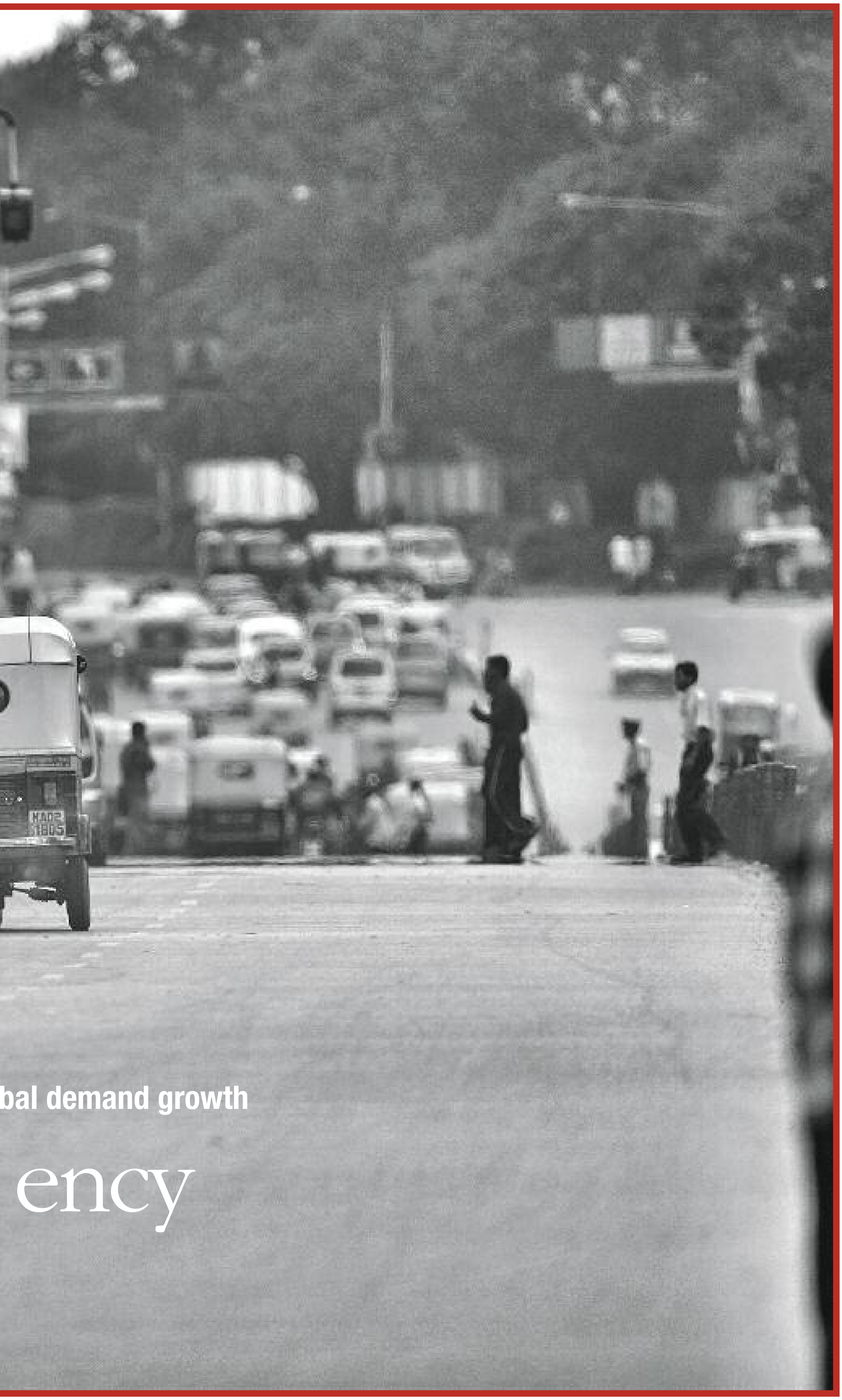
Mr. Graham is more hopeful that the pressure of an increasing energy deficit on Indonesia's finances could prompt a shift to a more open stance on international oil and gas investment, following the example of neighbouring Malaysia. "Indonesia still has good geological prospectivty," he says "It's just whether risk and reward makes sense."

"If Indonesia says 'we have to do something about getting companies into increased new green-field drilling,' the quickest and simplest way to do that is to stimulate investment activity by making improved fiscal regime terms and making the local regulatory and procurement environment more attractive. Malaysia has demonstrated the effectiveness of this."

E **India/The third largest Asian economy is on course to surpass China in terms of glo**

The threat of energy depend

India's scarcity of domestic hydrocarbons coupled with a dramatic rise in demand could put the country's energy security and public finances at risk as early as 2020



by JAMES CRABTREE

For two decades, China has been the rising giant of world energy markets. Over the next two decades, India will become just as important a force. The implications of the arrival of a second Asian superpower will be far-reaching, both for India, and for the future of the global energy system itself.

The growth of Asia's third largest economy shares many characteristics with that of its larger neighbor. Despite recent stumbles, India's development will be rapid; it will become the world's third largest economy over the next two decades. That growth will prompt rapid increases in energy demand, fueled by industrial growth, urbanization and a population that will overtake China to become the world's largest by mid-century, with an estimated 1.6 billion people.

A PROBLEM DESTINED TO GROW

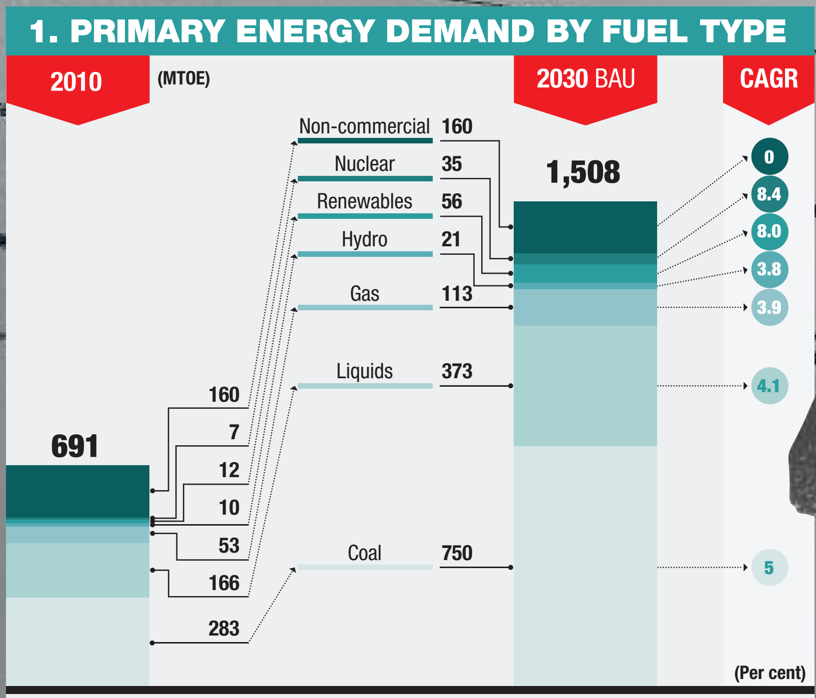
In some ways India's ascent is likely to prove more tumultuous than China's. India has scant domestic energy supplies, especially in oil and gas, a fact that already makes it one of the world's most energy dependent large nations. This problem is set to accelerate, as India becomes the dominant source of new global energy demand from the start of the next decade, severely endangering its energy security and public finances. Having won an overwhelming victory in national elections earlier this year, Prime Minister Narendra Modi will now look to increase domestic energy supplies and moderate expected leaps in demand, while introducing other reforms to upgrade creaking fuel subsidy and power systems. The scale of these challenges is daunting, however, and India's chaotic democracy has frequently failed to push through similar bold reforms in the past.

Avoiding a scenario in which India becomes the world's most energy dependent major economy will thus be difficult. Even if Mr Modi can push through unprecedented domestic reforms, rising demand will still require new energy supplies from abroad — and it is far from clear that New Delhi has a coherent plan to pursue this objective. "For many years and through to 2020 the engine of global energy demand has been China," says Fatih Birol, chief economist of the the Paris-based International Energy Agency. "But from around 2020 the growth com- →

THE AUTHOR. James Crabtree is the head of the *Financial Times'* Mumbai bureau, where he leads the paper's coverage of corporate India, having previously worked on the op-ed page as Comment Editor. Before joining the FT, Mr Crabtree was Deputy Editor at *Prospect*, Britain's leading monthly magazine of politics and ideas. Prior to returning to journalism, he worked as a policy advisor in the U.K. Prime Minister's Strategy Unit, and for various think tanks in Britain and America. He also spent a number of years living in the U.S., initially as a Fulbright Scholar at the Kennedy School of Government at Harvard University.

Indian energy

India's energy requirements, which in 2010 amounted to 691 Mtoe (mega tonnes of oil equivalent) in a BAU (business as usual) scenario, will reach 1500 Mtoe by 2030 (chart 1). Chart 2 shows how much of the fuel needed to satisfy Indian primary energy demand will come from domestic sources and how much will be imported. Although BAU assumes a substantial increase in the domestic production of coal, oil, gas, hydroelectric, nuclear and renewable energy, this increase is not sufficient to satisfy demand. As a result, Indian dependence on imports will increase from 30 to 51 percent of primary energy requirements (chart 3).



Source: McKinsey Global Energy Perspective, IEA, McKinsey analysis

ing from India will be higher, meaning that India will be the new China in terms of global demand growth.... everyone needs to pay more attention to how it is going to behave."

India's energy dependence problems were again on view this June, as violence flared in the Middle East. Global crude prices jumped as Islamist rebels captured the city of Mosul in northern Iraq. The rupee fell quickly, as did equity markets, on fears that further turmoil in Iraq would prove especially damaging to a country that imports around three quarters of its oil.

The country's broader problem is simple. "India has a fifth of the world's population, but only one 30th of its energy," as a report from investment bank Goldman Sachs put it recently. "It just doesn't produce enough to meet its needs. Hence, it has to import energy – oil, gas, and increasingly coal." India's import bill for gas alone rose sharply from $82bn in 2010 to $145bn in 2012, becoming the largest component of a record deficit in the country's current account. Reducing this dependence will not be easy, especially when most estimates say imports will keep rising from around 30 per cent of its energy needs, according to consultants McKinsey, to around 50 per cent by 2030.

India's last government set a target to become fully energy independent over that same period by increasing domestic supplies of oil, gas and renewables and introducing new curbs on energy demand. Most independent experts think this goal is all-but impossible — a senior executive at the IEA called it a "very, very, very ambitious target" — especially given limited proven domestic reserves, and the time required to increase production. Yet finding new sources of energy at home is just one part of India's problem.

THE HUB OF SUBSIDIES AND THE NEED FOR INVESTMENT

India also spends $43bn a year on subsidies, much of it for fuel. Ostensibly designed to help the poor, these subsidies also provide sops to the middle class, encouraging waste and over-consumption. Similar controls protect electricity consumers, leading to heavy debts among state-backed electricity boards, and unpaid bills for power companies. Elsewhere, India has plentiful supplies of domestic coal, but the lumbering state-backed mining giant Coal India is unable to increase supplies. Those power stations that do receive enough fuel then also see around a quarter of their output lost in transmission, or eaten away by fraud.

Mr Modi made early moves to tackle these problems by replacing a mishmash of government departments with a single ministry to cover coal, power and renewable energy. Even so, the list of further reforms needed to fend off a future crisis of energy supply is intimidatingly long. Reducing demand will be harder still, requiring tough new regulations to increase fuel efficiency in cars and buildings.

Investment presents a final problem. India's creaking energy system requires substantial injections of capital: more than $2.2 trillion by 2035, according to the IEA, most of it in the power sector. Coming anywhere close to this target will requires substantial sums from the private sector — at a time when fearful international companies have been steered well clear of India's complex and bureaucratic power and resources sectors.

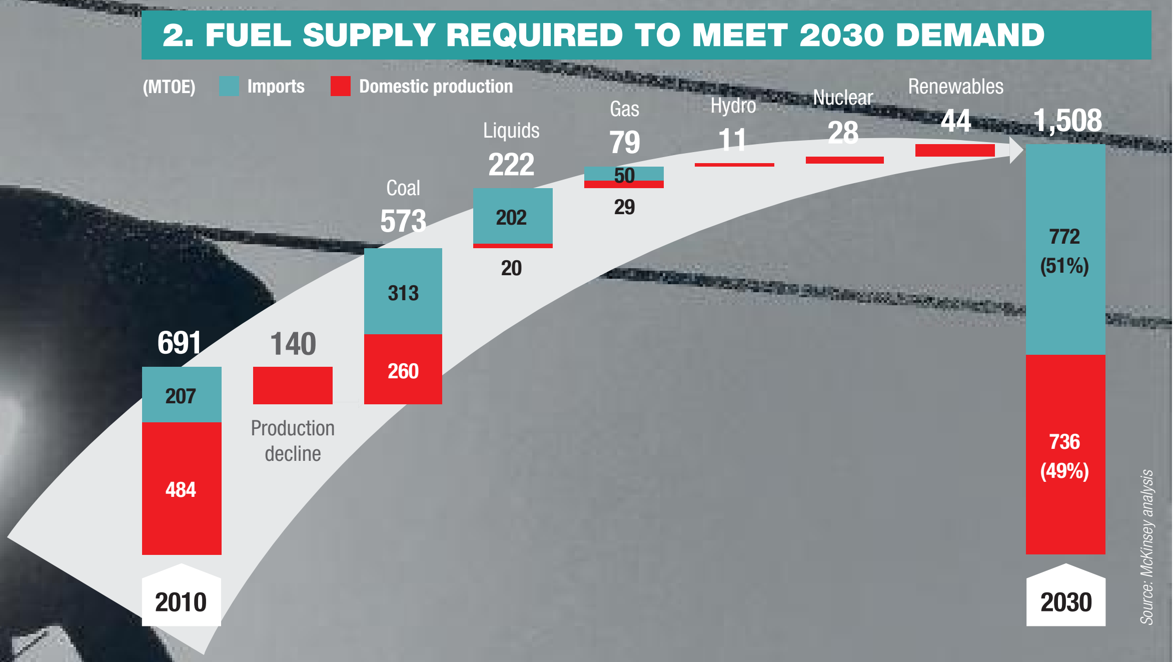
Ultimately a more radical shake-up of the country's state-dominated energy system may be needed, according to Sunjoy Joshi, the head of the Observer Research Foundation think tank in New Delhi. "Under the planned economy model adapted after independence, the Indian state gradually arrogated to itself responsibility for guardianship, extraction and conversion of fossil resources into useful forms of energy," he wrote in a recent essay. The result was the creation of a series of "gargantuan state energy companies" run directly (and inefficiently) from the capital.

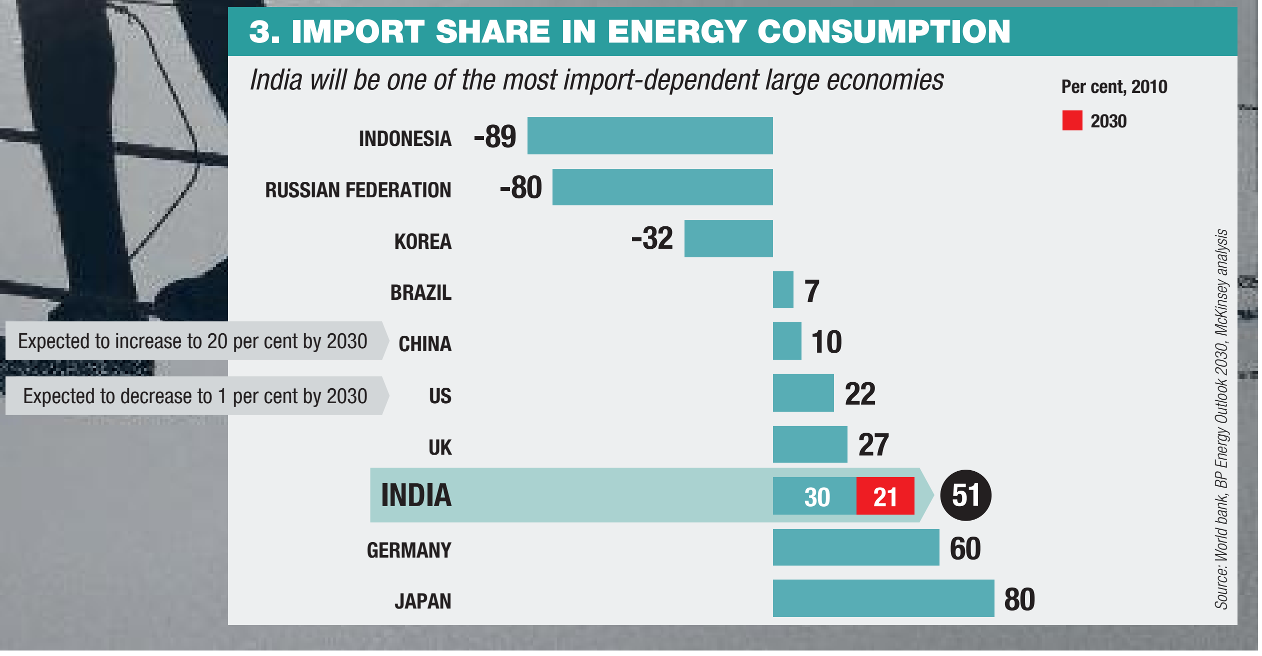
This government-dominated system is unlikely to be scrapped entirely in the near future, but it could be complemented by a much stronger private sector, alongside improved regulation, and a focus on new ideas. "With the world's largest expansion in energy markets imminent in the country, India must become the nerve centre for innovations in technologies" ranging from clean coal to non-conventional extraction such as shale gas, Mr Joshi writes. "It cannot afford to be relegated to a mere market for others."

POSSIBLE STRATEGIES

Even were Mr Modi to push forward with a full suite of domestic reforms, they would take time to deliver. Yet demand for energy keeps increasing. "India could put the most investor friendly policy in the world for oil and gas, given the resources it has, and they will still need to import incredible amounts," says Sasha Riser-Kositksy, an India analyst at Eurasia Group, a risk consultancy.

It is far from clear what strategy India plans to follow to secure these resources abroad. One option is to





follow China and begin snapping up foreign assets. Oil and Natural Gas Corporation, India's largest state-backed oil explorer, has made early steps in this direction. Last year it upped its stake in a Brazilian oil field, and spent $2.5bn for a portion of gas found in Mozambique. The company plans to invest a gigantic $180bn by 2030, much of it on foreign assets.

Even so, many analysts doubt whether following this Chinese-style model will prove effective. The approach is expensive, for a start, an obvious problem given India's limited funds. It also swaps one sort of risk — a rise in global oil prices, for instance — with another, namely a reliance on unpredictable governments in resource rich countries such as Venezuela or Uganda.

Then there are practical considerations. India's public sector energy groups, burdened by subsidies and led by cautious bureaucrats, are not in strong financial health. They have also tended to lose out in the race to secure foreign assets to faster and hungrier Chinese rivals. "This old mercantilist idea that national oil companies should be charging around the world buying up blocks has lost some currency in New Delhi," Mr Riser-Kositksy says. "It isn't at all clear that the national energy companies in India are better positioned to develop these blocks than international private oil companies."

India's state energy groups could be more successful if Mr Modi offers clear political direction and helps to repair their finances. But that alone does not overcome one further drawback, namely that the benefits of such investments may not flow back to India at all. India has spent more than $53bn on foreign oil and gas ventures over the last decade, according to Sanjay Joshi. "These investments may be touted as essential for India's energy security," he says, "however, production overseas even by Indian companies invariably found its way to the best available markets — and those are certainly not back home."

FROM OIL TO GAS

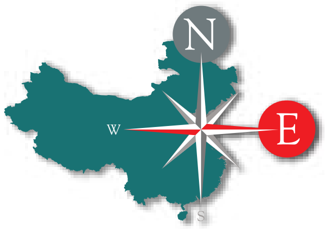
That said, relying on the vicissitudes of global oil markets can be just as problematic, as June's events in Iraq show. Part of the solution will come from cutting back on oil and shifting to imports of liquefied natural gas, where prices and supplies tend to be more stable. New gas pipelines could also help to deliver fuel from neighbouring exporters. Nick Butler, an energy economist at Kings College London, says other options are possible too, such as setting up an Indian energy trading company to buy in supplies, or building deeper relationships with international oil majors. "BP or Shell could do the job," he says, although linking up with foreign companies could prove politically controversial.

A recent McKinsey report on energy security points to other possible avenues, in particular closer ties with oil and gas exporting nations in the Persian Gulf and East Africa, such as Mozambique and Uganda, that will be seeking new markets given declining demand in the west following North Amerca's shale gas boom. "The Middle East and Africa, from being exporters to the west, will seek stable, large markets in the east," the authors write. "This shift gives India a unique opportunity to create an 'India-Middle East energy corridor' to enter into new contractual arrangements with oil and gas suppliers."

Building new connections with Middle East suppliers is therefore one part of the solution to India's energy dilemma, but it too comes with obvious complications. "India's growth will come at a time when oil production outside of the Middle East is slowing down," says Fatih Birol of the IEA. "India's growth will mean that the Middle East and India, and the Middle East and China, will be much more closely linked to one another." The geopolitical risk of this are clear. "Governments in India and China will have to keep an eye on the Middle East very closely," Mr Birol says. Ultimately, India faces no easy answers as it tries to find a route out of the trap of energy dependence. Rather than picking and choosing, its best strategy will almost certainly require pushing forward on all fronts at once, according to Nick Butler, beginning with far-reaching changes from Mr Modi's new government. "Modi has to create the climate in which private investment is able to proceed. That means a clear strategy, radical simplification of the bureaucracy, and where necessary some straightforward incentives. It will also require new engagement between India and key supplying countries," he says. "Overall it is quite a challenge, and a big test of how serious he is."

China/The energy resources and trade routes behind the recent disputes over the islands of the China Sea

The Dragon is looking to control the seas



In terms of tonnage, fifty percent of globally traded goods pass through the Straits of Malacca, Sonda and Lombok each year. More than ten million barrels of crude oil in tankers pass through the Strait of Malacca alone every day. These routes constitute the real jugular vein of Asia

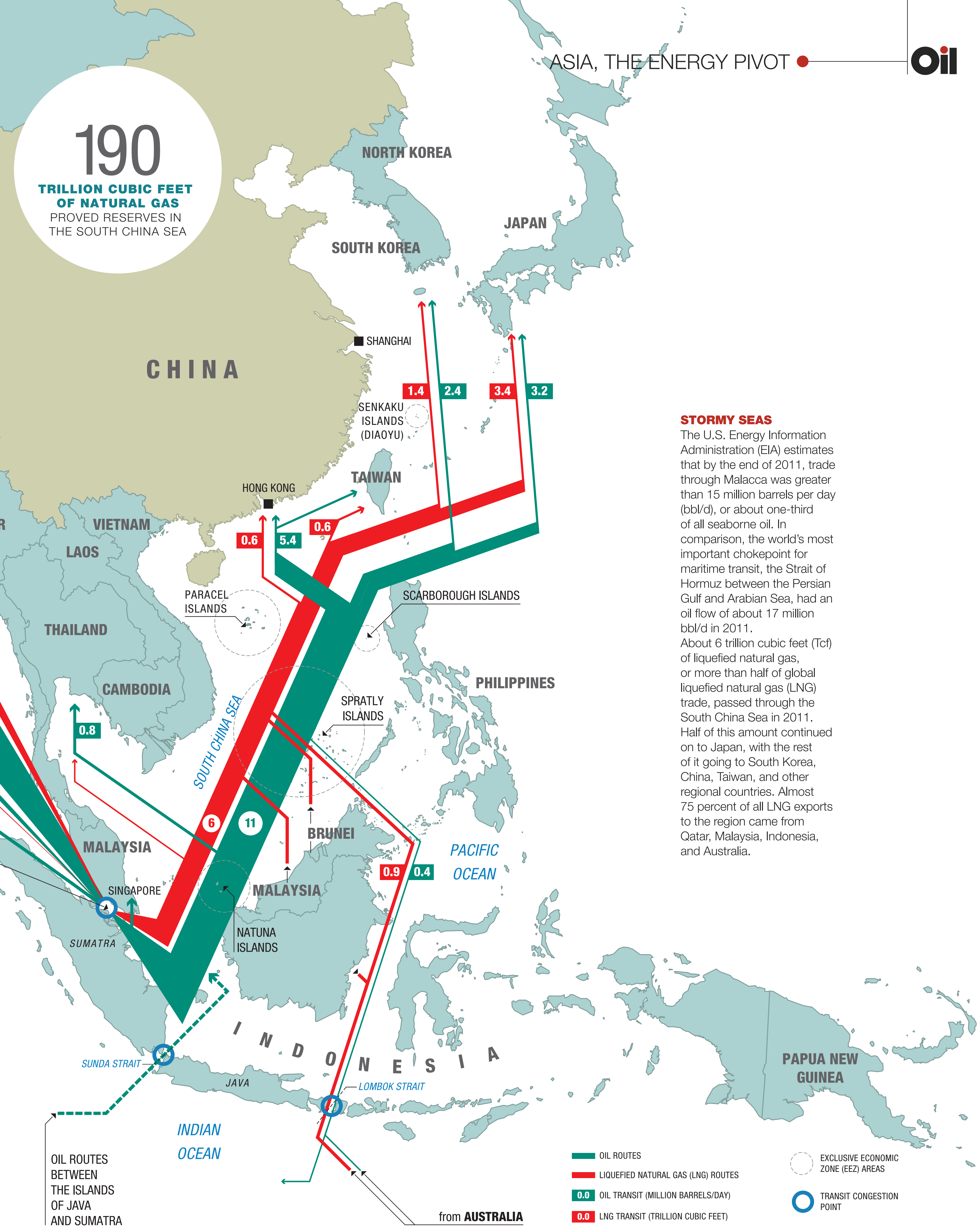
by
SEBASTIANO FUSCO
(AGENZIA NOVA)

Japanese incursions into the Beijing Air Defense Identification Zone (ADIZ) in the East China Sea pose a "threat" to the security and defense of China. The statement to this effect released by the Chinese Ministry of Defense spokesman, Geng Yansheng, on May 29, 2014, is only the latest in a series of declarations in recent years, by a range of countries related to the search for energy resources in that part of the Pacific Ocean. The terms used by the spokesman, though, were particularly ominous. A word usually used in the context of "threat of war" was employed to express the sense of "threat."

For those who know how to read these undertones, vital in eastern diplomacy, this verbal hype is important, especially if you consider the occasion that caused it, in other words the incursion into the Chinese ADIZ by two aircraft identified as being Japanese, an Orion P3C and an Namc Ys-11Eb, sent to "spy" on the progress of a joint Russian-Chinese naval exercise in the Beijing identification zone. The establishment of ADIZ, announced in November, sparked many incidents with Tokyo. The latest took place a few days after the announcement of the important agreement for the Russian company Gazprom to supply gas to Beijing, which was signed after ten years of negotiations.

The China Sea, with its different geographical areas, "south," "east" and "north," is gradually becoming one one of the most contested sites in which the fundamental game of the century—the competition for energy resources—is being played out. In order to understand it, simply take a look at the map. Overlooking the South China Sea, as well as China, you have Taiwan, the Philippines, Malaysia, Brunei, Indonesia, Singapore, Thailand, Cambodia and Vietnam. The area is dotted with islands, mainly grouped together in the archipelagos of Spratly and Paracel, several of which are contended by neighboring countries. Territoriality is vital, because it marks the boundary from which the Exclusive Economic Zone (EEZ) of each country is calculated. This can extend up to 200 nautical miles, equal to approximately 370 kilometers, from the base lines from which the extent of the territorial sea is measured.

Established in 1982 by the U.N. Convention on the Law of the Sea, the EEZ represents the area in which a coastal state holds exclusive rights of sovereignty for exploration, exploitation, conservation and management of resources. It has jurisdiction over the installation and use of artificial islands, systems and structures, and can adopt laws to regulate the various sectors of activity. It cannot, however, restrict navigation and overfly rights, nor the laying of undersea cables and →

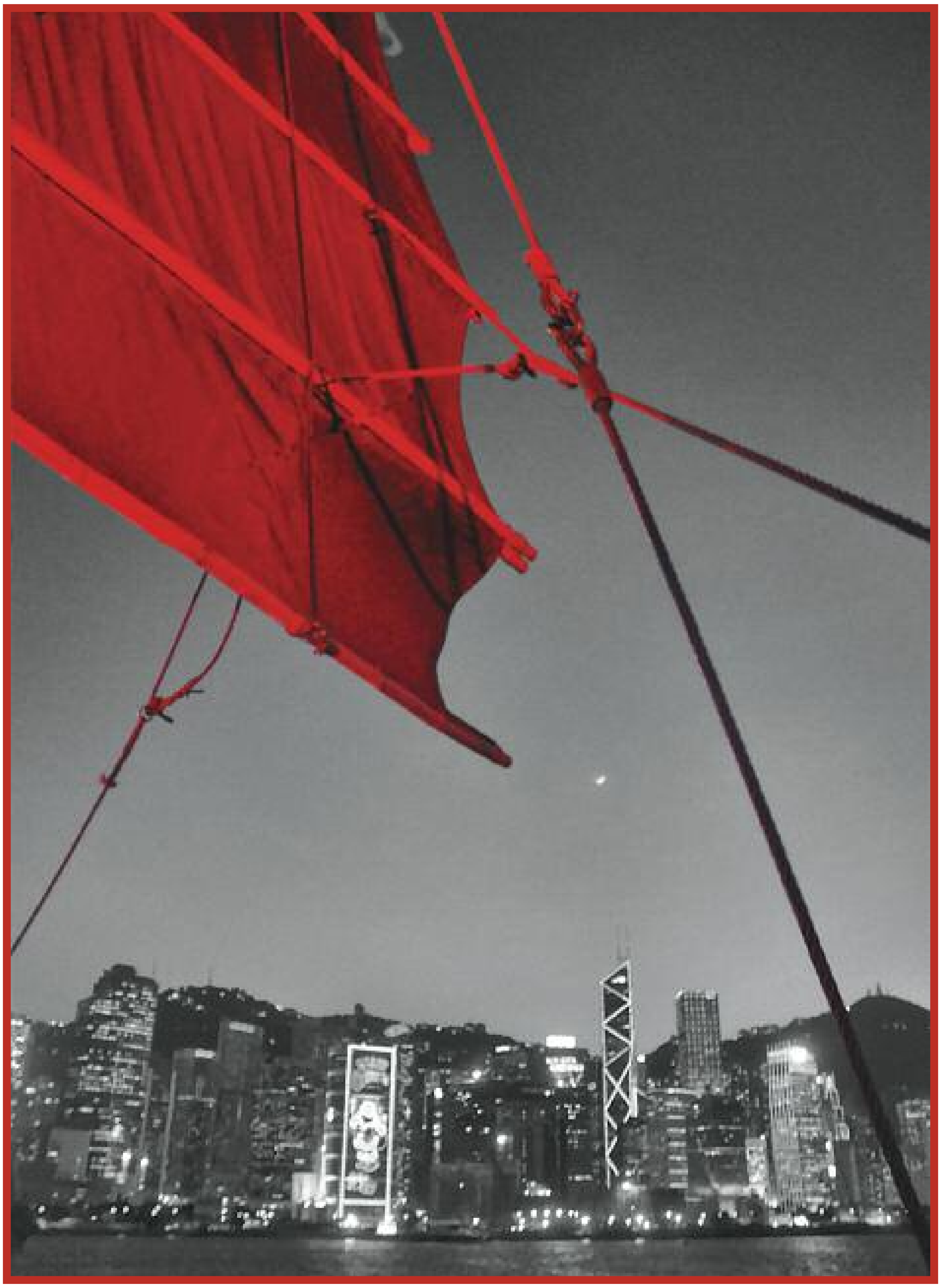


STORMY SEAS

The U.S. Energy Information Administration (EIA) estimates that by the end of 2011, trade through Malacca was greater than 15 million barrels per day (bbl/d), or about one-third of all seaborne oil. In comparison, the world's most important chokepoint for maritime transit, the Strait of Hormuz between the Persian Gulf and Arabian Sea, had an oil flow of about 17 million bbl/d in 2011.

About 6 trillion cubic feet (Tcf) of liquefied natural gas, or more than half of global liquefied natural gas (LNG) trade, passed through the South China Sea in 2011. Half of this amount continued on to Japan, with the rest of it going to South Korea, China, Taiwan, and other regional countries. Almost 75 percent of all LNG exports to the region came from Qatar, Malaysia, Indonesia, and Australia.

THE SOUTH SEAS ROUTES
Seventy percent of oil imported from China comes from Africa or the Middle East and passes through the South China Sea and the Strait of Malacca. Whoever controls these routes also controls the eastern half of the globe.



pipelines. China, Taiwan, Japan and South Korea border the East China Sea. The coasts of China and both North and South Korea are located near the North China Sea, the northern part of the East China Sea also known as the Yellow Sea.
The geopolitical importance of the South China Sea, beyond the gas and oil discovered there, lies in the fact that it includes the second busiest maritime route in the world in terms of traffic. In terms of tonnage, 50 percent of globally traded goods pass through each year, arriving via the Straits of Malacca, Sonda and Lombok. More than ten million barrels of crude oil on tankers pass through the Strait of Malacca every day. These routes constitute the real jugular vein of Asia: whoever controls the traffic passing through, also controls the eastern half of the globe.

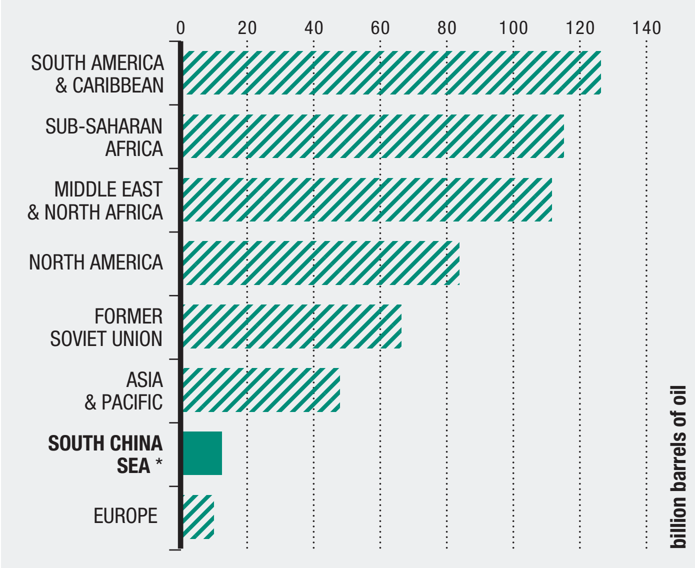
TRADE ROUTES

Control of these routes is of particular importance to China and Japan. Seventy percent of the oil that Beijing needs for its economic growth is imported from Africa and from the Middle East by sea, along routes that pass through the South China Sea and the Strait of Malacca to destinations as far as the Persian Gulf. For Japan, the oil import figure jumps to 90 percent, along the same routes that guarantee access to the Indian Ocean and beyond to the markets of the Middle East and Europe. As far as energy resources are concerned, reserves of at least 11 billion barrels of oil have been confirmed, and it is estimated that the figure could reach 28 billion barrels, according to a U.S. Energy Information Administration report issued in 2013. Natural gas reserves are estimated to be around 7,500 billion cubic meters. China also recently made important discoveries of natural gas in the East China Sea. And this is without mentioning other resources, such as fish stocks, which are vital to the economies of those regions.

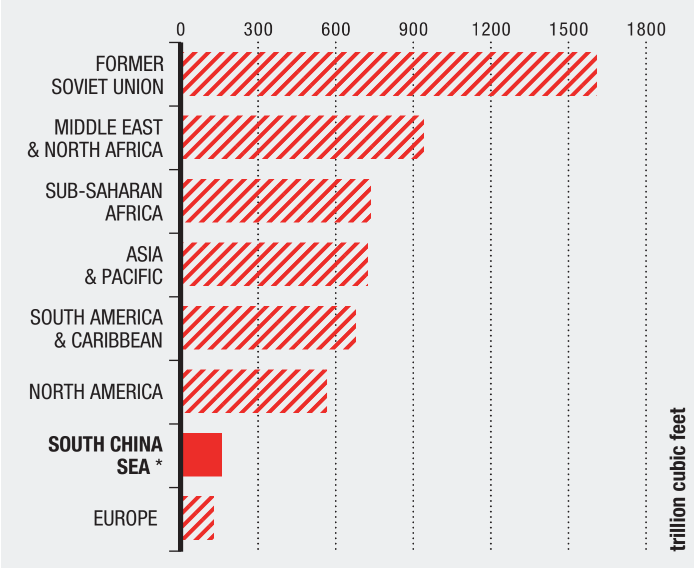
> The China Sea is becoming one of the most contested sites in which the fundamental game of the century—the competition for energy resources—is being played out

It is no surprise that, in practice, all the countries bordering on water have various ongoing disputes with one another over the exclusive economic interest zones. The Paracel Islands, about thirty atolls and reefs divided into two groups, are contested by the Philippines, China, Taiwan and Vietnam. Different parts of the Spratly Islands, a vast archipelago that includes roughly seventy atolls and islets divided into three archipelagos, are contested by practically all the countries bordering the South China Sea. The Senkaku Islands, not far from Taiwan and controlled by Japan, are claimed by China, which calls them the Diaoyu Islands. The sections of sea to the north east of the Natuna Islands, which extend between the Malacca Peninsula and Borneo, are disputed by Indonesia, China and Taiwan. The Scarborough Shoal is contested by China, the Philippines and Taiwan. Malaysia, Cambodia, Vietnam and Thailand are staking claims to

UNDISCOVERED OIL RESOURCES



UNDISCOVERED GAS RESOURCES



** Does not include Gulf of Thailand, Indonesia's Java, Borneo and Sumatra basins, or Sulu Sea.*

Source: U.S. Energy Information Administration

A HIDDEN TREASURE

EIA estimates the South China Sea contains approximately 11 billion barrels of oil and 190 trillion cubic feet of natural gas in proved and probable reserves. Conventional hydrocarbons mostly reside in undisputed territory. The U.S. Geological Survey (USGS) estimates that the South China Sea may contain anywhere between 5 and 22 billion barrels of oil and between 70 and 290 trillion cubic feet of gas in as-yet undiscovered resources.

various parts of the Gulf of Thailand. There are disputes between Malaysia and Singapore over the Straits of Singapore and Johor. And these are only some of the areas subject to international disputes.

THE PLATFORM OF DISCORD

Against this background, at the beginning of May, China initiated drilling operations for a platform located near the Paracel Islands, in an area that Vietnam claims as its own. The platform, owned by the China National Offshore Oil Corp., can operate in the open sea up to a depth of three kilometers and can drill down to 12 kilometers. It is the first time that a Chinese company has conducted such activities on its own, with a significant investment—the plaform cost nine hundred and fifty two million dollars.

Beijing made its move approximately two weeks after Barack Obabm's visit to Asia designed to strengthen America's China containment strategy. To defend the structure, Beijing has deployed a fleet that includes around eighty ships with naval and coastguard units, and it has announced that exploration activities will continue at least until August 5. The Vietnamese government, after vigorous protests to China, sent its own ships, which, according to statements from Hanoi, were rammed by the Chinese ships and kept at bay through the use of hydrants.

The “naval battle” saw six injured and various craft damaged. Protests throughout Vietnam ensued, taking a violent turn, when, on May 13, Chinese-owned factories in two industrial zones in the province of Binh Duong were attacked, with three of them set on fire. Also at the beginning of May, another incident involving the Philippines took place.

A Chinese fishing boat accused of fishing protected species in waters near Manila was seized. The area in question, near the Scarborough Shoal, was claimed by China, which issued a provision stating that authorization from Beijing was needed to fish. The Philippines, attempting to reassert sovereignty over the area, issued their own provision stating that authorization from Manila was needed to fish there. There were anti-China demonstrations in Manila as well.

It is obvious that Beijing's moves have been implemented with the intention of testing the international response to its efforts to achieve hegemony over all parts of the China Sea. With the platform close to the Paracel Islands, China has put the tolerance threshold of Asian countries to the test, and has set a precedent in relation to other countries in the region, which are arguing over the disputed areas.

> Seventy percent of the oil that Beijing needs for its growth is imported from Africa and from the Middle East by sea, along the routes that pass through the Strait of Malacca

The strategy appears simple: consolidate your presence where you already actually have control, like in the Paracel Islands, then expand it with a fait accompli policy in areas like the Spratly Islands where Beijing's presence is not so strong. For the time being, the strategy appears to be a winner. On 10 and 11 May, at the ASEAN summit, the Association of Southeast Asian Nations, to which China does not belong, “concern” was expressed over the dispute between Hanoi and Beijing, but in the end only a generic document was produced, in which those involved were invited to solve the problem peacefully, without any mention of the oil platform.

BEIJING'S NAVAL POWER

Protecting its interests in the area of Japan, the Philippines and, now, paradoxically, also Vietnam, is the United States, whose Seventh Fleet, the most powerful in the world, is stationed at the Yokosuka naval base in Japan. The alliance between Washington and Tokyo has so far induced Beijing to show preference toward land pipelines for energy procurement, strengthening alliances with Central Asian countries. Recently, however, the Chinese leadership adopted a new strategy, aimed at rebalancing the power on the seas, by strengthening its own navy and naval bases. The deployment of the Dong Feng-21 D anti-ship missile, dubbed the “aircraft carrier killer” by U.S. experts, is certainly tied to this new approach. A ballistic missile with a three thousand kilometer range, it would be capable of neutralizing a U.S. aircraft carrier. And so it's deployment clearly shifts the balance of power in the Pacific. Washington responded to this challenge with a series of confidence building initiatives, including naval exercises in the Sea of Japan and various development aid plans.

Meanwhile, Beijing is continuing to strengthen its naval power further, albeit with various difficulties, due to the limited experience of a country traditionally seen as a land-based power.

We are a long way off from a major shake-up of power relations, not only in terms of technology, but also economic power. In the meantime, however, Beijing's expansionist policy, concentrated on getting hold of energy resources, appears to be more stabilized on a north-south axis. Toward the north, agreements with Iceland, Canada, Greenland and Denmark, are bringing to the fore a desire to open up a new Sino-European great maritime route. A route which, starting from China, will reach Canada through the Bering Strait, arriving at Greenland and then Iceland, before reaching the North Sea, as far as Germany. All of this is designed to be able to take part in exploiting the immense deposits of hydrocarbons through fracking in North America. It is significant that China recently stated it was ready to build a high- speed railway line, using its own resources and funds, which will extend from China to North America, with a tunnel passing under the Bering Strait.

The second driving force behind Beijing's expansion, toward the south, must go through the China Sea and the control of its resources and maritime routes that pass through. And it is there that the real game, which has only just begun, will most likely be played out. ■

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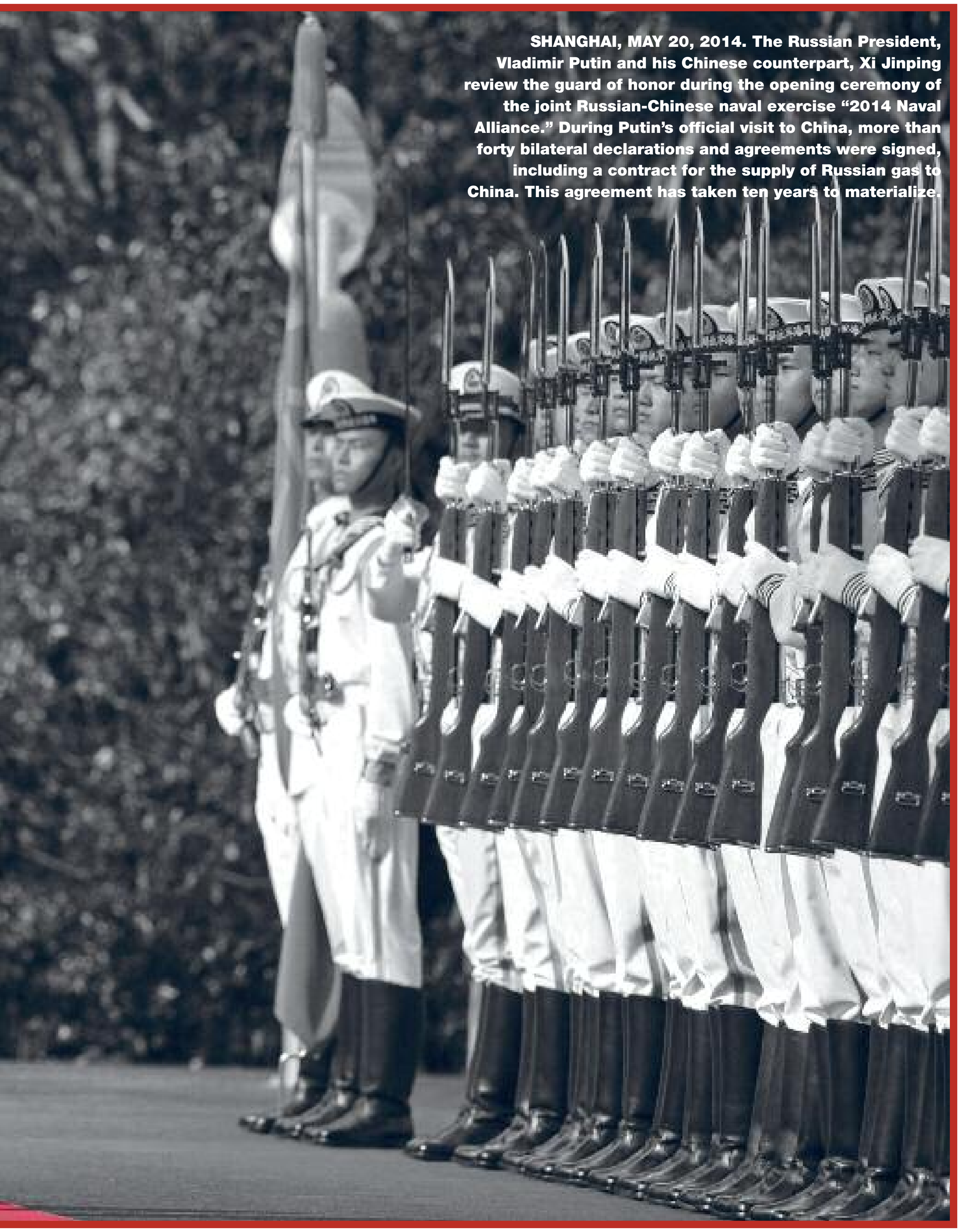
China/The implications of the historic gas agreement signed with Russia

How long will the honeymo

Energy cooperation between the two Asian giants will bring advantages to both, but the enforcement of the agreement could give rise to problems. The future will be full of compromises and negotiations



SHANGHAI, MAY 20, 2014. The Russian President, Vladimir Putin and his Chinese counterpart, Xi Jinping review the guard of honor during the opening ceremony of the joint Russian-Chinese naval exercise "2014 Naval Alliance." During Putin's official visit to China, more than forty bilateral declarations and agreements were signed, including a contract for the supply of Russian gas to China. This agreement has taken ten years to materialize.

on last?

by LIFAN LI

On May 22 by Russia's Gazprom and China's China National Petroleum Corporation (CNPC) signed a 30-year contract, the terms of which call for Russia to send 38 billion square meters of natural gas to China per year at a price linked to that of oil. The contract, the largest to date for Russia, will see Russian gas begin to flow to Russia in early 2019. This new natural gas alliance between China and Russia will bring significant influence to the international natural gas market and future energy market.

A WIN-WIN COOPERATION

• First, the agreement offers a win-win situation for both China and Russia. For Russia, the deal means a further step toward diversification of its exports. The amount of natural gas sent to China every year, at 38 billion square meters, will surpass the 34 billion sent to Europe. Russia also gets a long-term client and abundant funds for developing new districts. China, for its part, has obtained a reliable supplier for "blue fuel." Novatek, Russia's largest independent natural gas producer, also signed an agreement with CNPC to supply China with 3 million tons of Yamal LNG. A new balance can be shaped after China becomes the new recipient for LNG in Northeast Asia.

• Second, the terms of the agreement are less favorable for China. The contract also calls for the construction of a pipeline from Siberia to western Inner Mongolia that will deliver 30 billion square meters of natural gas. Russia's demand that the price of natural gas be linked to that of oil means Russia will charge China $380-388 per thousand square meters, equal to the price charged by Europe and higher than that from the Middle Asia natural gas pipeline, which is $352. A Take or Buy Clause was also included in the agreement, requiring China to purchase a certain amount of gas in a given year. If that amount is not met, China is required to pay.

• Third, the agreement means that Russia will become the "matrix" which supplies gas for Eurasia. President Putin expects to connect the pipeline near west Siberia and South Russia, allowing the gas previously sent to Europe to be redirected to the East. And because the two sources of natural gas in the agreement are not connected with the source to Europe, Europe lacked an excuse to interfere with the contract. In the future, Russia will become more active in manipulating the energy from Russia to East Asia.

• Fourth, the implication of the agreement lies on the pricing right snatched from the US. Asian countries formerly relied on the American model for pricing LNG. The agreement between China and Russia gave a serious stroke to the U.S. and Australia, which had to purchase gas cross-sea. Since the cost of LNG is relatively high, it cannot be sold if the pricing is higher than the transaction value between China and Russia. Before the signing of the agreement, the price of LNG in Northeast Asia peaked again in Feburary. Prior to Putin's visit to Beijing, the price index dropped nearly one third. After the agreement was finalized, the share price of Rosneft rose despite the recession in Russian stock market, exhibiting the importance of Russian natural gas in the international market.

• Fifth, Russia took into acccount China's choice of the pipeline direction. Russia had expected to send natural gas from western Siberia to the Xinjiang Province of China. However, China wanted to begin the eastern line first due to the existence of Middle Asian pipeline and West-East →

Russia-China gas deal

- 30-year agreement to start in **2018**
- **38 bcm** of Russian gas to be delivered to China annually
- est. price: **380-388 US dollars** per 1,000 cubic meters
- **construction of a pipeline** from Siberia to western Inner Mongolia

2004
Gazprom and CNPC sign strategic cooperation agreement

2006
Gazprom begins Altai project

2007
Gazprom starts building the Power of Siberia gas pipeline to China

2010
Agreement settles on 68 bcm per year

2013
Altai pipeline project halted, Power of Siberia prioritized by Gazprom

2014
May 21 CNPC-Gazprom gas deal

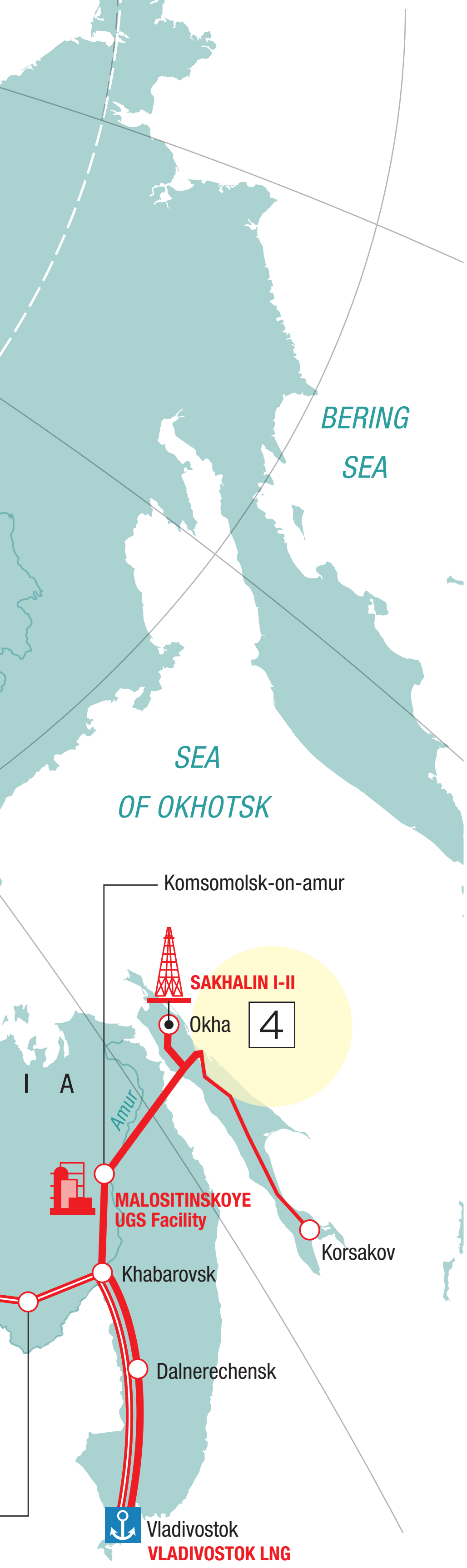
Transportation pipeline and the stronger demands of Northeast China, Beijing, Tianjin and Hubei Province. Russia respected China's preference.

• Sixth, the decline of Russia's status in the world economy has not changed. The Sino-Russia cooperation cannot change the fact of Russia's recession," despite the magic of the China's position as the world factory and market.

The above six aspects will have global implications. The pipeline connecting China and Russia is different from those between China and Australia and China and Indonesia. The construction of the pipeline should be finished before the mining, which might directly influence the downstream customers if there were no gas. However, even if there were not enough gas from the two sources in the agreement, the other sources could be extracted based on Russia's experience in west Siberia.

INFLUENCE ON THE FUTURE WORLD ENERGY MARKET

The transaction will influence the LNG trade transported by tanker,



which might, however, be less competitive. Assuming a price of $380 per square meter, the cost will be 30 percent lower than former sea route imports. According to estimates, the emergence of new energy will mean the end of supply shortages of LNG by 2015. With pressure on price brought by the new Russia pipeline supply, Russia will not launch other LNG export projects in the near future.
Second, some gas producers will face further pressure. China has been seen as one of the most promising markets for LNG. With the signing of Sino-Russian contract, some countries are worried about exporting LNG to China. The largest gas producers, such as Australia, Mozambique, the US and Canada, see China as a new market for LNG offering generous profits. However, the increase of natural gas supply from Russia will put countries like Canada in a disadvantaged position. The "obscure" price of natural gas exported to China from Russia will further compress the seller's market.
Third, the challenge of US shale gas exports remains. Although America's export of shale gas is increasing, the shortage of pipeline and disadvantage of price cannot shake the important position of Russian natural gas in Europe. Therefore, Russia's energy exports to the region will continue to grow. After the eruption of the Ukraine crisis, Europe considered importing U.S. shale gas in large amounts in order to end its dependence on Russian natural gas. However, the construction of infrastructure over the continents is consuming in time and cost. Meanwhile, the price of natural gas in the Asian Pacific market, roughly 1.6 times higher than that of Europe, attracts more attention from the U.S.

> In the future, China, Europe and Russia could evaluate the development of a Pan-European and Asian Union for natural gas, taking on a dominant role in the international market

Fourth, Russia will continue energy negotiations with Ukraine without changing its energy cooperation with Europe. China clearly realized that Russia would not treat the U.S. as the main competitor for energy export and export to Ukraine would still be the part of Roneft's energy strategy. However, Russia has been worried about the threat to its exports to Europe posed by Ukrainian extremists. This has lead to consideration of alternative pipelines. Russia is constructing its "south line," which connects directly to Austria from the Black Sea without passing through Ukraine. Russia still considers its supply of natural gas to Europe mutually beneficial.
First, China and Russia's currencies cannot challenge the western gold dollar system. After the signing of the contract, the trade can be settled by RMB or RUB, reducing losses that might be caused by dollar fluctuation. Given the weaknesses of both currencies, China and Russia will not abandon cooperation with the western countries, which put an end to the commitment to "fighting the U.S."
Second, Russia needs to develop the Far East to diversity its fund source. The two principle countries of the region are China and Japan. Since Japan joined the G7 in the sanctions against Russia and expects LNG exports from the U.S., China might be the only investor in Russia from the Far East. Russia can utilize the capital from China to reduce its own expenditure in short term. However, the situation will not last long. After the signing of the contract, the vice prime minister of Russia suddenly visited Japan, which could be seen as a clue for further development.
Third, China's "comprehensive strategy" will arouse dissatisfaction from Russia. China expects not only to purchase the energy, but also to participate in upstream mining and obtain control of the energy. Due to the limited prospect of the new gas field, the mining is not invested and the upstream field is not shared by China. The lack of paid service in upstream oil and gas field from China will displease Russia. The energy demands created by China's rapid development cannot be satisfied solely by Russia. Therefore, the attitude of Russia will adapt in the future.
Forth, Russia has projects "trespassing" on China. The 30-year contract between Russia and China suggests Russia's intention to develop further relationships with Asian countries. Russia considers to focus on the fast developing market besides China. For example, the demands of natural gas from India in 2020 will increase in great amounts. India cannot get more energy besides LNG. Therefore, Russia is preparing for increased demand from India. Russian and Indian companies have signed a series of contracts. India was strongly advised to join Russian projects in case China suspends its investments in India.
Fifth, South Korea and Japan expect to join the natural gas relationship between China and Russia. South Korea paid intensive attention to the contract and wished to join the "branch project" of the pipeline construction quickly. South Korea proposed that China build a seabed natural gas pipeline connecting Shandong and Inchon. It also advised that Russia provide natural gas by those made by South Korean companies in Middle Asia, which had enough capital and technological advantages, through west seabed pipeline. If the pipeline can connect Russia with China and South Korea, extending to Japan in the future, it can be utilized to restrain North Korea for making nuclear weapons, thus playing an important role in keeping peace in Korea Peninsula.
Sixth, facing the honeymoon of China and Russia, other natural gas producers will launch a guardian war. Although details of the contract were not disclosed, it nonetheless aroused worries in other gas producers. For example, if CNPC agrees to pay a price higher than Turkmenistan, the latter may require to change the relative clauses in the contract with China. The same might applies to Burma and push the price of China's exports higher. Keeping the price a secret will create a distinct win-win situation for both China and Russia.

CONCLUSION

The cooperation between China and Russia has positive implications. However, further problems might emerge with the application of the contract. Future cooperation will require more negotiation and compromise, especially in the development of technology.
In future energy cooperation, China will focus more on the pricing model and propose a reasonable bargain. As a long-term contract, the pricing system should consider hook conditions. In the contract, the price of natural gas price is connected to that of oil and a "pay without further discussion" clause was added. However, the model is challenged in Europe. Recently Eni has corrected its gas supply agreement with Russia, connecting the price to spot price, which is more flexible and beneficial for the purchaser. In the future, China, Europe and Russia may consider developing a "Pan Europe and Asia Natural Gas Union" and take a dominant role in international energy market.

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Li Lifan is Associate Research Professor at the Shanghai Academy of Social Sciences and Secretary General of the Center for Shanghai Cooperation Organization Studies.

A BRIDGE BETWEEN EUROPE AND ASIA
May 29, 2014 – the Presidents of Russia, Kazakhstan and Belarus, Vladimir Putin, Nursultan Nazarbayev and Aleksandr Lukashenko, sign an agreement ratifying the establishment of the Eurasian Economic Union (EEU). The EEU will be operational from January 1, 2015. By 2019, a joint market for electricity should be established, followed, by 2025, by a joint oil & gas market and a joint financial regulator

A NEW ERA IN RELATIONS WITH CHINA
May 21, 2014 – after ten years of fruitless negotiations, Moscow and Beijing signed a historic agreement in Shanghai for the thirty-year supply of 38 billion cubic meters per year, from 2018, through a 2,200 kilometer pipeline from Siberia to Eastern China, yet to be built. The agreement, which is worth $400 billion, paves the way to a new era in relations between Russia and China

Russia/At the center of a network of alliances that will shift the global balance

Moscow looks to the East

Not only to China, but also beyond, to the Association of Southeast Asian Nations members, not forgetting the Eurasian Union. By 2025, Russia, Kazakhstan and Belarus should create a joint oil & gas market

by EVGENY UTKIN

While the whole world was focusing on Ukraine, Vladimir Putin struck gold 8,000 kilometers to the east: in the last hour of a visit to Shanghai, he managed to pull off a $400 billion contract for the supply of gas to China (see page 26). Very few people had taken the agreement as a given, first, because negotiations had been ongoing for ten years and second, because, on the first day of the official visit of the Russian President, no mention was made of the agreement's signing. Now, "the biggest agreement in the entire history of the gas industry in Russian and Soviet history" – as noted by Putin himself – was signed by Gazprom and CNPC (China National Petroleum Corporation). The agreement involves the annual supply of 38 billion cubic meters of gas from 2018 onwards via a yet to be built 2,200 kilometer pipeline from Siberia to Eastern China, opening a new era in relations between Russia and China, and probably also for those between Russia and Europe.

Technically, the Europeans don't have anything to worry about: the fields from which the gas will be transported in two opposite directions are different, remote and not connected to one another. The gas destined for Europe will therefore arrive in Europe without touching Chinese interests. Politically, however, this is a significant step. It is a sign that Russia's international policy is not looking exclusively to the West more

THE AUTHOR. Evgeny Utkin is a journalist and expert on the Russian economy and energy issues. He writes for the Milan edition of *Quotidiano Energia*, and works for many Italian publications (*La Repubblica* and *La Stampa*, in particular) and foreign ones such as *Expert*. He worked as a researcher at the Moscow State University before becoming a manager for intergovernmental and international companies such as Eutelsat and Ericsson.

Chinese President Xi Jinping and his Russian counterpart Vladimir Putin (L) during the opening ceremony of the fourth CICA summit in Shanghai on May 21, 2014.

Russian President Putin (R), Kazakh President Nazarbayev (C) and Belarus President Lukashenko take part in a meeting of the Eurasian Economic Union in Astana on May 29, 2014.

ASEAN leaders at the 24th ASEAN Summit in Naypyidaw (Myanmar). The recent tension between Vietnam and China has prompted ASEAN to call for restraint in the disputed territory.

generally or specifically to Europe (even though it does trade with it more by $400 billion), but to the East, in the direction of China, and not only China.

A few years ago, Russia had in mind a single cultural and commercial area that stretched from Lisbon to Vladivostok and harbored doubts about associating itself with the pipelines to China, but those days are over. Now, with energy from Russia (bought at a good price), the Dragon will run even faster towards economic supremacy, with the United States slipping back into second place, while Russia will develop its remote areas in Siberia, bringing employment and well-being there too.

THE ASTANA AGREEMENT FOR THE EURASIAN UNION

Committed to all of this, Moscow has not forgotten one of its ambitious plans: the Eurasian Union. Just a week after signing the agreement with China, another important agreement was announced. In Astana, the capitol of Kazakhstan, Vladimir Putin, Nursultan Nazarbayev and Aleksandr Lukashenko, the Presidents of Russia, Kazakhstan and Belarus, respectively, signed an agreement deemed "of historic proportions," ratifying the establishment of the Eurasian Economic Union (EEU). The EEU will start operating on January 1, 2015.

"While keeping our national sovereignty intact," stated Putin, "we will ensure a closer and better coordinated economic cooperation." The States (there may be new members) will adopt measures aimed at guaranteeing the free movement of goods, services, capital and labor. Further, for the main sectors – energy, industrial production, agriculture and transport – it will adhere to shared codes of conduct. While the creation of a joint financial regulator and a joint oil & gas market may not happen until 2025, the common electricity market, on the other hand, should be established by 2019. Russia, which wants to be the cornerstone of relations between Europe and the East, continues to build, with great determination albeit some difficulty (with the question of Ukraine hanging over), views these entities as central to its goal. And, disappointed by Europe and its "lack of understanding" toward Moscow in the Ukrainian crisis, it finds itself having to move more quickly toward the East, not only toward China, but even further, toward the ASEAN (Association of Southeast Asian Nations) countries.

While there is strong skepticism in the Old Continent about the "Europe project," as recent elections (which saw the number of anti-European Parliamentary candidates increase exponentially) have shown, the ASEAN countries are trying to achieve greater integration and create an ASEAN Economic Community by 2015, a union with many similarities to the Eurasian Economic Union. It involves a market with 600 million people, with one of the highest growth rates on the planet. And Russia does not want to stand by and be an observer from the outside. For a few years it has increased its economic presence in the region and it is now thinking about creating a mutual fund to promote commercial trade and the development of mutual business. There is great interest in the field of energy (not only the extraction or sale of gas & oil, but also the possible development of nuclear power).

TOWARD A MULTIPOLAR WORLD

Although most are relatively "poor" (e.g., Myanmar, Cambodia and Laos), the ASEAN countries have enormous potential for development. While China suffers from the legacy of the one child policy and sees its workforce gradually decreasing, the ASEAN countries offer an enormous reserve of labor. It is not by chance that Japan decided to divert many investments in its manufacturing industry to places like Vietnam, Cambodia, the Philippines and Indonesia. China, with an increasingly rich middle class and rampant domestic labor costs, has opened factories in ASEAN countries, while continuing to be a leader in the sector of infrastructures and supply chains. But ASEAN countries clearly have areas of strength: Thailand is growing in the field of automotive related industries, Vietnam is counting on its ability to provide labor at extremely competitive prices, while Laos and Cambodia are excellent suppliers of electricity. Clearly, Beijing can no longer afford to sit tight, especially because it has political rifts with various countries in the ASEAN group. This includes Vietnam, which – if it had to choose – would prefer to be under the protective wing of Russia rather than kowtow to the hated Chinese giant.

In short, in addition to its obvious economic interests in the region, Russia cannot forget its geopolitical interests either. While Moscow should be very careful in the Ukraine situation and cannot afford to put one foot wrong, especially trying to avoid a war near its borders or even the direct involvement of its armed forces, in the Far East, the games seem far simpler or at least not so dangerous. Collaboration with ASEAN (and then probably with the respective unions) would create another center of influence, lightening the load of China which could be "unwieldy." At the moment, the routes taken by China and Russia to wrest economic supremacy from the United States coincide, but afterwards Russia will avoid creating another global monopoly through its own hands. Therefore, it's in Russia's interest to contribute to the development of other centers of power, like the Eurasian Union and ASEAN, which together with the U.S., China and Europe ensure that the world is going in a multipolar direction, which is probably the only possible condition for making it safer and more stable. ■

E U.S./The "pivot to Asia" strategy is advancing at a slow pace

Obama's missed opportunity

Despite the Obama Administration's promise of a shift toward the East, there has been little effective action toward rebalancing U.S. economic, political and military policies to date

by MOLLY MOORE

"The Mediterranean is the ocean of the past, the Atlantic the ocean of the present and the Pacific is the ocean of the future."

That was the global analysis made by U.S. Secretary of State John Hay more than a century ago. President Barack Obama echoed the same theme early in his first administration when he announced his "pivot to Asia" foreign policy strategy. The shift in U.S. global strategy was billed as part of America's recognition of the growing economic, political and geopolitical power of the region.

THE GAP BETWEEN WORDS AND ACTIONS

In recent months, however, headlines around the world have been asking what happened to the pivot. Critics complain that America's announced focus on Asia has been drowned by a cacophony of other world crises and U.S. entanglements in Afghanistan and Iraq.

"We wonder whether the United States is able to have a sustained engagement in the region, given its main priorities and the state of domestic politics within the United States," Thailand's Permanent Secretary of Foreign Affairs, Sihasak Phuangketkeow, said during an address to the defense minister's conference, know as the Shangri-La Dialogue held in Singapore in March.

The pivot was aimed at America "strengthening bilateral security alliances; deepening our working relationships with emerging powers, including with China; engaging with regional multilateral institutions; expanding trade and investment; forging a broad-based military presence; and advancing democracy and human rights."

From the beginning, close U.S.

BARACK OBAMA
President of the U.S.
«As President I made a conscious and strategic choice: as a nation of the Pacific, the United States will play a greater and more long-term role in shaping this region and its future, supporting fundamental principles in close cooperation with our friends and allies.»

allies such as Japan and Vietnam viewed the new U.S. interest as a stabilizing influence. China, in contrast, viewed the move as a regional power grab.

America's failure to execute the rebalancing of its economic, political and military policies toward Asia reflects the extraordinary difficulty a superpower and its bureaucracy have in changing course at any of those levels. Actions, invariably, are slow to catch up to political pronouncements. For the Obama administration, progress has been thwarted by domestic and international public opinion that increasingly is questioning Obama's foreign policy leadership not just in Asia, but across the globe. A recent New York Times/CBS News poll reported that 58 percent of Americans disapprove of the way President Obama is handling foreign policy, the highest level since he assumed office in 2009.

THE ASIAN ENERGY ISSUE

No issue is more critical to Asia today than energy. Consumption in Asian nations is growing at the fastest pace in the world. China has been the world's largest energy consumer since 2010 and this year surpassed the U.S. as the world's largest oil importer.

It's no coincidence that one of the most significant regional crises this year involved a power struggle over oil. Earlier this summer, China moved its largest oil rig—a behemoth $1 billion platform the size of a football field—into waters off the disputed Paracel Islands in the South China Sea. The islands, about 120 miles offshore from Vietnam, are claimed by both Vietnam and China; Beijing's aggressive move has left Chinese and Vietnamese relations at their lowest point in years. U.S. Defense Secretary Chuck Hagel accused China of taking "destabilizing unilateral actions."

However, Obama's focus on Asia has waned since 2012 when one of his top Asia officials at the State Department, Kurt Campbell, declared during a conference hosted by Foreign Policy magazine:

"We recognize at a fundamental level that most of the history of the 21st Century is going to be written in the Asian Pacific region, and anyone who doesn't really understand just needs to look at trade dynamics and educational issues, population issues, climate change, anything. This is the dominant arena of strategic interactions. . . . It is in our best national interests to demonstrate that we are going to play a role in that drama."

His boss, then-Secretary of State Hillary Clinton who is now widely regarded as the leading Democratic contender in the next U.S. presidential elections, conceded at the time: "This kind of pivot is not easy," but added, "We are committed to seeing it through as among the most important diplomatic efforts of our time."

Clinton and her top Asia official, Campbell, along with the other Obama administration officials who were the key supporters of the pivot to Asia strategy, have since left the administration and discussion of the rebalancing has been tepid. Obama and his current Secretary of State John Kerry have been far more focused elsewhere.

THE DELAY IN THE TRANS-PACIFIC PARTNERSHIP AGREEMENT

A casualty of that inattention has been the centerpiece of U.S. - Asia policy, the Trans-Pacific Partnership, a 12-nation trade agreement designed to reduce tariffs and create trade rules that will streamline economic relations and eventually lead to a broad free-trade agreement for the entire Pacific Rim region. Other participants include Australia, Brunei, Canada, Chile, Malaysia, Mexico, New Zealand, Peru, Singapore and Vietnam. The countries involved—which do not include China—represent about 40 percent of the world's domestic gross product.

HILLARY CLINTON
former U.S. Secretary of State
«This kind of pivot is not easy, but we are committed to seeing it through as among the most important diplomatic efforts of our time.»

U.S. National Security Advisor Susan E. Rice earlier this summer described the agreement as "a key pillar of our rebalance to Asia."

The trade pact originally was scheduled to be inked by December 2013. It remains mired in opposition from some of Obama's fellow Democrats in Congress. The latest obstacle is a battle over regulations for Asian catfish imports in the agricultural component of the agreement.

KURT CAMPBELL
former Assistant Secretary of State for East Asian and Pacific Affairs
«We recognize at a fundamental level that most of the history of the 21st Century is going to be written in the Asian Pacific region, and anyone who doesn't really understand just needs to look at trade dynamics and educational issues, population issues, climate change, anything. This is the dominant arena of strategic interactions.… It is in our best national interests to demonstrate that we are going to play a role in that drama.»

Some critics argue that the only major action resulting from the the pivot has been military. Obama's announcement of a small training base for 2,500 U.S. Marines in Australia and movement of a few more naval vessels towards the Pacific are viewed by many as weak examples of any shift.

In fact, America's Asian allies have criticized Obama for not being aggressive enough in intervening in China's territorial grabs of disputed territories off Vietnam and the Scarborough Shoal claimed by the Philippines in the South China Sea.

The U.S. Senate's Committee on Foreign Relations' April report "Rebalancing the Rebalance: Resourcing U.S. Diplomatic Strategy in the Asia-Pacific Region" found that "despite progress in some areas, implementation of the rebalance thus far has been uneven which creates the risk that the rebalance may well end up as less than the sum of its parts." The document noted, "The rise of the Asia-Pacific region may well prove to be the single most transformative geopolitical shift of the 21st century. In the past 20 years, China and India's share of the global economy has tripled. By 2025, the Asia-Pacific region will account for almost half of the world's economic output."

The U.S., the Congressional committee warned, needs to assure "our partners that we are in it for the long haul."

At the slow rate the pivot is moving, that might take some convincing.

SIHASAK PHUANGKETKEOW
Thailand's Permanent Secretary of Foreign Affairs
«We wonder whether the United States is able to have a sustained engagement in the region, given its main priorities and given the state of domestic politics within the United States.»

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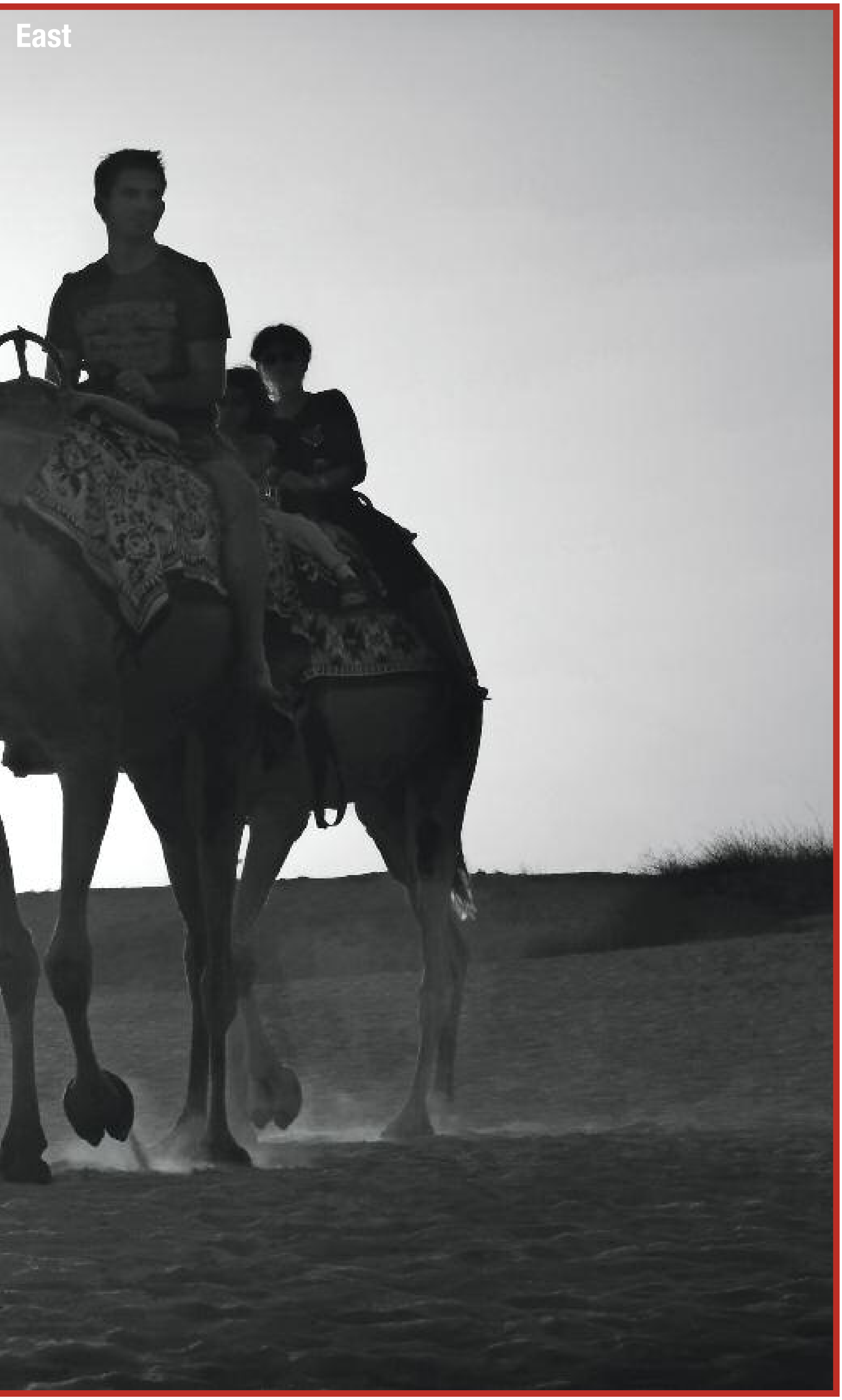
Molly Moore is a senior vice president of Sanderson Strategies Group, a Washington, D.C. media strategies firm, and a former *Washington Post* foreign correspondent.

E The Middle East/The impact of America's tight oil and the shift in demand to the

What does the future hold for the Gulf countries?

The increase in demand in the Asia-Pacific countries over the last twenty years has been absorbed primarily by Middle Eastern producers, and demand for oil in the region will continue to increase. The region does face challenges from a number of outside sources, but its greatest challenges may well come from within



by BASSAM FATTOUH

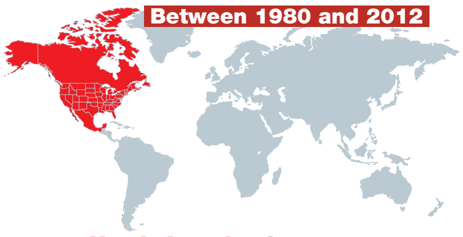
The oil industry has a long history of alarmist forecasting about supply and demand, which has often proven to be quite wrong. Fears in the 1950s and 1960s that oil demand growth was unsustainable and would lead to unaffordable prices proved only partially correct: prices in the 1970s and early 1980s did spike, but forces soon pushed them back down. A period of global economic recessions, combined with the discovery of major new oil provinces outside the Middle East (in the North Sea and Alaska) and increased use of gas for power generation, confounded those apocalyptic views. Far from choking off demand, oil prices collapsed in the mid-1980s, ushering in nearly two decades of low oil prices and inadequate upstream investment. Similarly, following the Asian crisis of the 1990s, which sent oil prices down to $10 per barrel, some commentators predicted that the world would remain awash with oil. Less than a decade later, oil prices touched a historic high just below $150 per barrel.

THE TROUBLE WITH FORECASTING

The industry's poor record in predicting fundamental shifts in the market has been made worse by recent developments in U.S. energy markets. Not only did most industry and oil market analysts fail to predict the scale of the tight oil revolution in the first place, but now that the pendulum has swung in the opposite direction, expectations regarding the impact of the tight oil revolution on global supply dynamics appear over-hyped. For instance, some have warned that "the world might be drifting into an oil price shock," describing the current situation as "very reminiscent of the period 1981–86 which culminated in the dramatic 1986 oil price collapse. Others have argued that "the growing continental surplus of hydrocarbons points to North America effectively becoming the new Middle East by the next decade." However, this notion that the abundance of tight oil would create a supply glut in crude or refined products and cause a sharp drop in oil prices has yet to materialize. While the tight oil revolution had a localized impact on U.S. crude prices over the last two years – as seen in the temporary dislocation of WTI and the huge discounts of regional grades -, the quarterly average Brent price has been above the $100 per →

barrel mark for the last 14 successive quarters and the output from key Middle East producers has been historically high.

Given this changing landscape, commentators are raising questions about the future role of the Middle East and its position in the global political and energy order. Some analysts believe that the impact of the shale revolution on Middle East producers will be transformational. For instance, in a recent article in this magazine, Moises Naim argued that "while Saudi Arabia and other Middle East producers will continue to be important players in the global energy markets, their dominance enjoyed for most of past century will no longer be the central feature of this market. The implications of this trend are enormous, ranging from the military to the commercial and

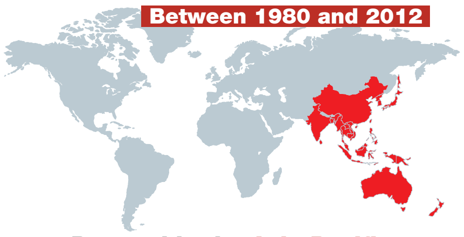


North America has seen its consumption rise from 20 to 23 million barrels per day

perhaps even the social." Citibank holds a similar view, arguing that "some producer countries…those suffering most acutely from the resource curse may see their leadership come under heightened pressure for economic and political reform, as revenues gradually diminish, raising the risk of creating new failed states in the process." Will these predictions turn out to be true this time round? To answer this question, we must first consider some of the basic facts and trends and how these are shaping Middle East producers' behavior and choices.

DOMINANCE IN TRADE OF CRUDE OIL AND OIL TRADE ROUTES

Although there have been many moving parts in energy markets, there are three global trends, with far-reaching consequences on Middle East producers, that stand out. The first is the shift in oil demand dynamics towards the East. The second is the US tight oil revolution, which has shifted the perception from oil scarcity to oil abundance. The third is geopolitical in nature and relates to the United States' "pivot" to Asia – though, as noted in Molly Moore's article in this issue, there remains much uncertainty over

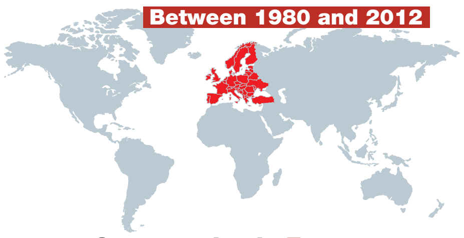


Demand in the Asia-Pacific region has increased by approximately 10.5 million barrels per day to almost 30 million barrels per day, an increase of approximately 20 million barrels per day

its content, its potential effects on U.S.-Asia relations, and on whether this pivot is actually taking place.

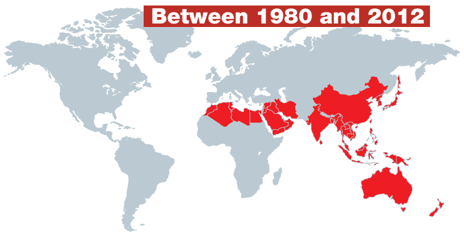
To appreciate the scale of the shift in oil demand dynamics, some basic statistics are in order. Between 1980 and 2012, the Asia Pacific region increased its demand from around 10.5 million b/d to almost 30 million b/d. In contrast, during this period, North America increased its consumption from 20 million b/d to 23 million b/d while, in Europe, consumption declined from 23.5 million b/d to 18.5 million b/d. Most of the demand growth in Asia Pacific has been met by Middle East and North African producers. From a low of around 12 million b/d in 1985, exports from the Middle East and North Africa (MENA) to Asia Pacific exceeded 22 million b/d in 2012. This represented more than 40 per cent of the world's total exports of crude oil that year. MENA accounted for 44 percent of China's, 66 percent of India's, and 75 per cent of Japan's import requirements. In 2012, more than 75 percent of Middle East exports were destined to Asia Pacific.

This trend is likely to continue into the next two decades. Although oil is likely to be the slowest growing fuel during that period, BP predicts that global liquids demand (oil, biofuels, and other liquids) will rise by a further 19 million b/d by 2035. This demand growth will come exclusively from rapidly growing non-OECD economies - with China and India accounting for most of the net global increase. This implies that, for the foreseeable future, Asia will continue to rely on imports of Middle Eastern oil.



Consumption in Europe has fallen from 23.5 to 18.5 million barrels per day

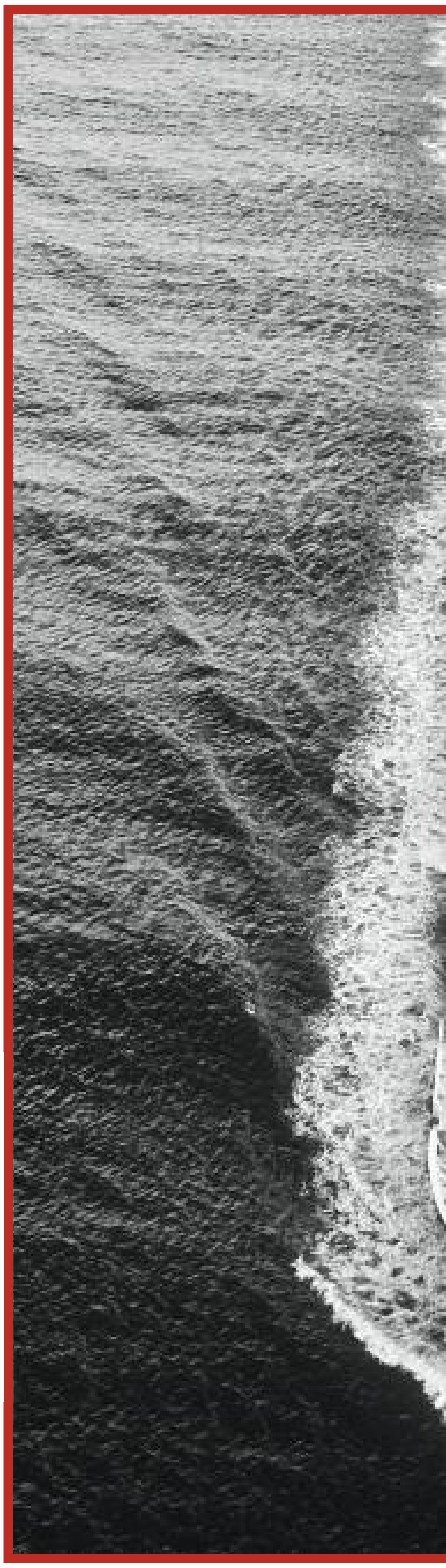
Given that oil is expected to continue to flow towards the East, securing trade routes is of key importance. Trade routes can be blocked at strategic chokepoints, namely locations "that limit the capacity of circulation and cannot be easily bypassed, if at all." The oil market is vulnerable to the closure of transport routes owing to its high reliance on tanker transport: more than 1.9 billion tons of petroleum products a year are shipped by maritime transportation, constituting around 62 percent of all petroleum products. The Straits of Hormuz off the Iranian coastline constitute one of the world's most important oil shipping chokepoints. About 88 percent of all the petroleum exported from the Persian Gulf passes through the Straits of Hormuz – approximately 17 million b/d, or 20 per cent of the world's oil supply – serving key customers in Japan, Europe, the USA, and other Asian customers. Alternatives to the transport of oil by tankers via the Straits of Hormuz remain limited. Until recently, the only significant alternative outlet for oil from the Arabian Peninsula was the Saudi Arabian pipeline to Yanbu on the Red Sea, but this pipeline can only handle around 4.8 million b/d. In January, 2012, Abu Dhabi reported the completion of a pipeline that circumvents the Straits of Hormuz: the new 370 km pipeline runs from Habshan in the south-west of Abu Dhabi to Fujeirah's export terminals located on the Gulf of Oman, and carries up to 1.5 million b/d of crude oil, slightly more than half of Abu Dhabi's current crude production of some 2.7 million b/d. A second direct pipeline between Abu Dhabi and Fujeirah would add only limited additional capacity in view of the traded volumes of oil that pass through the Straits each day.



The increase in demand in the Asia-Pacific region has mostly been absorbed by producers in the Middle East and North Africa

THE ROUTES OF LIQUEFIED NATURAL GAS

Free passage through the Straits of Hormuz is also of strategic importance for the transport of a range of

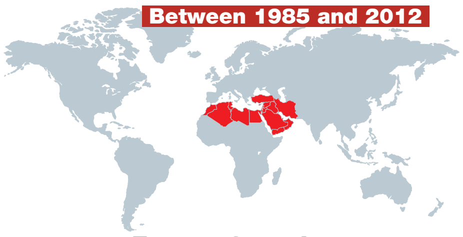


other strategic goods. About a quarter of global Liquefied Natural Gas (LNG) supplies transits through the Straits, the majority being some 77 million tons per year of Qatari LNG shipments destined for Asian and European markets. LNG transport from and to the Persian Gulf, unlike oil, faces a situation in which there are no immediately available alternative trade routes. For some of Qatar's long-term contract clients, particularly those in Asia, the simultaneous loss of Qatari LNG and

Persian Gulf oil supplies would be a worst-case scenario. The result could be a scramble for alternative spot oil and LNG, which would ultimately drive up prices for both commodities.

Thus, supply shocks due to disruption in production or trade routes, originating either from the Middle East or elsewhere, will be felt globally through their impact on international prices. Thus, even if the U.S. imported no Middle East oil, it would still have a strong interest in protecting against supply disruptions. For such supply shocks to have no impact, the U.S. would have to cut off its economy and oil market from the rest of the world through isolationist policies, which is highly unlikely, to say the least.

This highlights another dimension of why the Middle East is central to oil markets: the world's spare oil production capacity is still concentrated in the Middle East, mainly in the hands of Saudi Arabia and to a lesser extent in other Gulf States. In case of disruptions, spare capacity can help stabilize oil prices while keeping global stocks at healthy levels. Between 2011 and 2013, more than 1,600 million barrels of oil production were lost due to outages arising from the Arab Spring and sanctions linked to Iran's nuclear program. Key Middle East producers have proactively used their spare capacity to fill the gap. The combined output of Saudi Arabia, Kuwait, Qatar, and the UAE has risen from around 14 million b/d prior to the start of the Arab Spring to above 16 million b/d for much of the last three years. This has not just been an increase in absolute terms. Problems affecting other OPEC members have led to the Gulf States' share of total OPEC production rising above 50 per cent since the beginning of the Arab Spring – touching 55 per cent in September 2013.



Exports from the Middle East and North Africa (MENA) to the Asia-Pacific region have increased from 12 million barrels per day to over 22 million barrels per day (equal to more than 40 percent of total global crude oil exports for that year)

The MENA region accounts for 44 percent of China's import demand, 66 percent of India's and 75 percent of Japan's

US TIGHT OIL PRODUCTION

The received wisdom, only a decade ago, painted a picture of a U.S. economy increasingly reliant on oil imports, especially from the Middle East, to meet rising demand for transport fuels as domestic oil production declined. Quite the opposite has happened in the last few years. The size of the U.S. oil supply shock has been nothing short of phenomenal. From a negative annual growth in 2008, the U.S. has added around 1 million b/d in liquid production in 2011, 2012 and 2013, with similar growth expected for 2014. As a result, oil-import dependency has declined and the old rule of thumb that saw oil imports from Saudi Arabia, Canada and Venezuela equal to around 15 percent of the U.S. total has changed dramatically. Now Canada, not the Middle East, is the most important foreign supplier of oil to the U.S..

But would this rapid growth displace the position of the Middle East as the most important source of supply growth? Not necessarily. It is difficult to envisage how a high-cost producer could squeeze a low-cost producer out of the market. In fact, one could argue that a high cost producer such as the U.S. can introduce more elasticity to the supply curve and hence supply would become more responsive to upward and downward price movements, helping to put a floor and a ceiling on the oil price - which is highly desirable from the GCC producers' point of view.

Furthermore, given the size of the Middle East countries' reserves, most international organizations predict that meeting long-term growth in oil demand implies higher, rather than lower, reliance on investment in the region towards the end of the next decade. In its latest World Energy Investment Outlook, the IEA stresses that the focus should be on the Middle East, where investment has to increase to offset declines elsewhere. Should investment fail to pick up, the IEA suggests, oil prices will be around $15 higher than current prices by 2025, in real terms. There is the risk that expectations of lower demand for Middle East oil could induce some of the producer countries to slow down their investment. After all, in an environment of high uncertainty, the option to wait and not invest until new information becomes available is highly attractive.

In short, even if the U.S.'s oil production surpasses that of Saudi Arabia, significant differences will remain. Production in the U.S. will be consumed domestically, while the Middle East will continue to be a net oil exporter. This strong position in international oil trade gives the region its special position. Furthermore, Middle East reserves are the biggest and some of the cheapest in →

More than 75 percent of Middle Eastern exports were destined for the Asia-Pacific area

THE STRAIT OF HORMUZ
Approximately 88 percent of all oil exported from the Persian Gulf – 17 million barrels per day – passes through the Strait of Hormuz before making its way to key customers in Japan, Europe, the U.S.A. and other Asian markets.

the world to develop. The region would continue to compete even in a low oil price environment. This is not the case for U.S. producers.

It is not that the growth of tight oil has had no impact on global oil market dynamics. For instance, the diversion in trade flows has had significant implications for Middle Eastern producers. Since the decline in the West's appetite for oil and the burgeoning growth in the East, Middle Eastern producers have turned towards Asia in order to secure stable long-term customers for their crude. Moreover, the growing economies of Asia were largely at the mercy of Middle Eastern suppliers through most of the last decade, given declining regional production and the lack of alternative sources of imports. Today, however, cheaper West African barrels, helped by extremely low freight rates, are proving to be attractive in Asia at a time when other crude exporters – such as Russia, Mexico, and Venezuela – are also trying to move away from Western markets and capture the main growth market of Asia. As tight oil production grows, exporters to the U.S. – namely Venezuela, Mexico, Nigeria, among others – will increasingly look East to find buyers for their crude. Once the Panama Canal is widened, this trend will intensify further. Thus, Middle Eastern producers may have to compete more aggressively in Asia if they want to maintain their market share in the region. However, to imply that these shifts in trade flows will erode the position of the Middle East is rather premature, especially at times when oil demand in non-OECD countries is expected to continue to rise.

THE RISKS FROM WITHIN

While the increase in U.S. tight oil production and the shift in trade flows will continue to shape global oil markets, there are shifts in the internal dynamics of the Middle East that could have a much bigger impact on the position of the region within the global energy order. Many of the region's countries, including those unaffected by the immediate repercussions of the Arab Spring, have responded to the upsurge in political turmoil across the region by increasing their social spending - which means that oil exporters have become even more dependent on high oil prices and revenues. Political turmoil and fear of regional spill-overs have also altered many regional oil and gas producers' priorities in social spending; this will affect sectoral policies such as the ability of governments to implement large energy infrastructure projects and adjust their fiscal terms to attract foreign investment. And the turmoil has reinforced pre-existing difficulties in reforming the region's domestic energy markets, most importantly energy prices, with likely consequences for medium- and long-term domestic energy demand growth, which will affect some of the MENA oil and gas producers' export capacity. In fact, one of the disturbing trends in the region over the last three decades has been the faster growth in regional oil consumption compared to its production. Although many MENA countries have large resource endowments, transforming these endowments into revenue requires high levels of investment and long-term strategic planning, including the attraction of foreign investment and technology into the sector. NOCs in MENA are not of uniform quality, and while some are relatively well-managed and score highly on commercial performance, human resources, and technology, others perform very poorly and have to rely heavily on foreign companies for exploration and the development of oil reserves. While MENA countries have grappled with a variety of investment barriers for years, the Arab Spring has reinforced some of the barriers which have the potential to further affect spending and investment priorities across different MENA oil and gas producers.

THE PIVOT TOWARDS THE EAST

So where does this leave the Middle East amidst the U.S. "pivot" to Asia? Some believe the pivot and lower dependency on imported oil from the region will erode America's interest in the Middle East and its relations with traditional GCC oil and gas exporters. Others argue that that oil market is one great pool and supply shocks in any part of the world will affect oil prices and hence the U.S. can't isolate itself from such shocks. Some would argue that American interest in the region is motivated not only by securing oil supplies and oil trade routes but by wider security interests, including Israeli security and counter-terrorism. The reality is that U.S. foreign policy towards the Middle East is still in flux. It is true that a U.S. less dependent on imported oil will have more flexibility in its foreign policy choices. The risk though remains that some distorted views about oil market dynamics and perceptions that the Middle East is no longer central to oil market stability could induce some radical foreign policy shifts with detrimental effects on an already unstable and fragile region.

THE GULF WILL GO ON

For Gulf oil producers, the switch in focus from West to East reflects economic realities: as OECD oil-demand growth has eased, developing economies in Asia and Latin America have more than taken up the slack. With the share of oil and natural gas in global primary energy demand expected to hold at around 50 per cent through 2035, according to the IEA, the call on Gulf oil will continue to increase. The U.S. shift towards oil independence will inevitably shift oil trade patterns in the years ahead but cannot take away the Gulf's unique market position: its dominance in international trade, the size of the reserve base, the cost of developing these reserves and the ability of key producers to swing their production. Perhaps the region's most fundamental challenges originate domestically, in the shape of deteriorating investment environments in some parts of the region, the rising domestic oil consumption throughout the region, and oil producers' lack of success in diversifying their economies.

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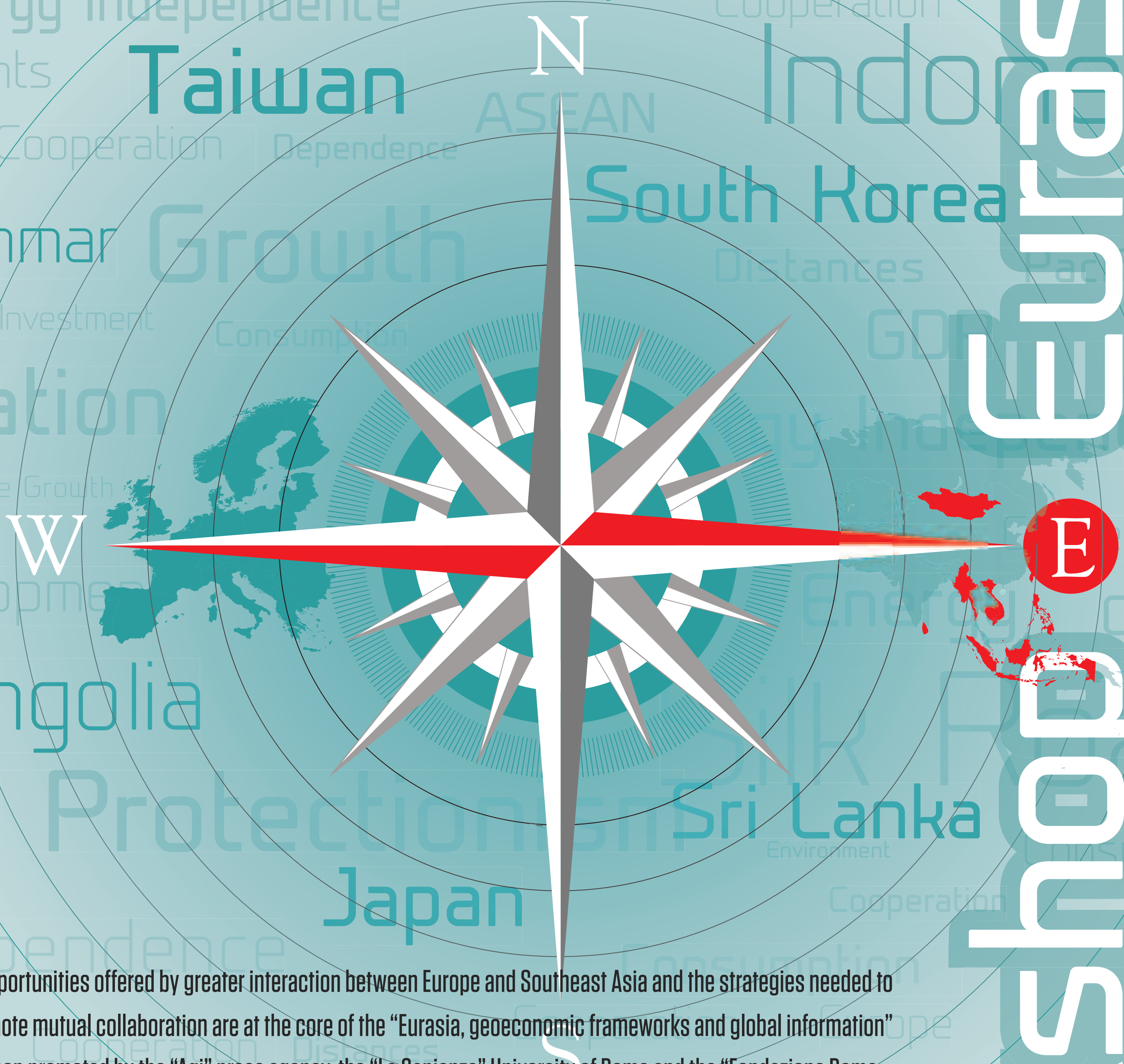
In addition to his role as Director of the Oil and Middle East Programme, Bassam Fattouh is also Research Fellow at St Antony's College, Oxford University; and Professor at the School of Oriental and African Studies.

Workshop Eurasia

ROME · JUNE 9/10



The opportunities offered by greater interaction between Europe and Southeast Asia and the strategies needed to promote mutual collaboration are at the core of the "Eurasia, geoeconomic frameworks and global information" workshop promoted by the "Agi" press agency, the "La Sapienza" University of Rome and the "Fondazione Roma – Mediterraneo," under the auspices of the Italian Ministry of Foreign Affairs. Representatives of the entrepreneurial and diplomatic worlds, members of the leading international organizations and central banks, journalists and academics from thirteen countries from the Far East and Southeast Asia all shared the stage. The proceedings were divided into four sessions: [1] in the first session the development models of the East Asian countries and their political and economic structures were analyzed. [2] The second session focused on investment opportunities in emerging Eurasian markets and strategies for attracting capital to Europe. [3] The third session considered the role of information in an increasingly global context. [4] The fourth and last session was dedicated to "diplomacy for growth" in Southeast Asia. The pages that follow contain the workshop opening address by the Under Secretary for Foreign Affairs, Benedetto Della Vedova, and highlights from the speeches of other speakers. The special edition begins with an interview with the Deputy Director General of the Ministry of Foreign Affairs, Andrea Perugini.

Europe/Andrea Perugini, Deputy DG of the Italian Ministry of Foreign Affairs

Growing together

Southeast Asia is carving out a role as a key player on the global scene. It is vital for the EU to take advantage of the business opportunities offered through close cooperation with the countries in the area

by SERENA VAN DYNE

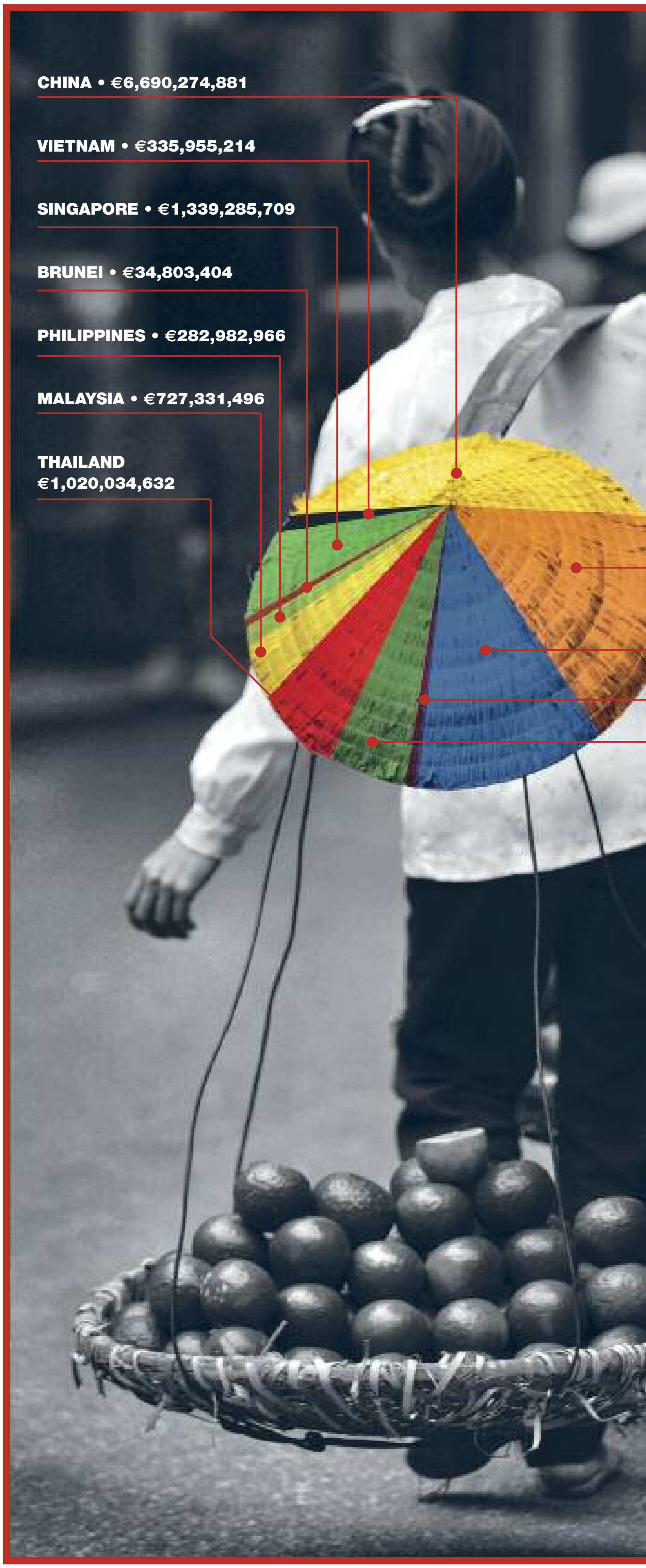
The balance of world equilibrium is shifting increasingly toward the East. Asia currently accounts for 30 percent of global GDP, 33 percent of trade and 40 percent of growth, making it one of the main players on the global stage. Southeast Asian countries, specifically, demonstrate an energy that is difficult to discern in the Organization for Economic Co-operation and Development (OECD) area and have, for some time, been the subject of a great deal of attention from world superpowers. Italy and, more generally, the European Union, must take advantage of the trade and business opportunities offered by increased cooperation with the countries of that area, supported by an ever increasing mutual awareness. Promoting this awareness is the goal of the "Eurasia, geo-economic frameworks and global information" workshop, which was held in Rome on June 9 and 10 (see the pages which follow). The workshop, promoted by the AGI press agency, "La Sapienza" University of Rome, and the "Fondazione Roma Mediterraneo," under the auspices of the Italian Ministry of Foreign Affairs, is the first in a series of major international events designed to promote the growth and development of the areas and strengthen dialogue with them. On October 16 and 17, 2014, Milan will play host to the Asia-Europe Meeting (ASEM) and in 2015 there will be an expo dedicated to fundamental themes for Eurasian countries. *Oil* spoke about this and a lot more to Andrea Perugini, Deputy Director General and Principal Director for Countries of Asia and Oceania of the General Directorate for globalization and global affairs of the Italian Ministry of Foreign Affairs.

What is the aim of this conference?

The conference is dedicated to a specific Asian dimension of great and primary importance: Southeast Asia, always an integral part of that immense land mass known as Eurasia. The workshop, with the significant participation of the Under Secretary for Foreign Affairs, Benedetto Della Vedova, has contributed directly to increasing awareness of this part of Asia. This is something that the Ministry of Foreign Affairs has been seeking to do for some time in order to promote greater awareness of the continent in Italy, its various scenarios, prospects of a political-strategic nature, and obviously as well the economic opportunities it presents for our country.

Why in Rome?

Italy can boast a significant wealth of historical knowledge about Asia. Since



ITALIAN EXPORTS TO ASIA

The value of Italian products exported to Asian countries is just under €18 billion per year. The lion's share goes to China, accounting for over €6 billion, while Brunei imports just over €38 million of made in Italy products. Laos and Cambodia, countries toward which exports are not very significant, do not appear in the graph.

Source: Istat. The data refers to 2012

the 2nd century B.C., silk produced in China reached the homes of Roman noblemen thanks to Indian and Persian trade initiatives. Roman merchants – according to Chinese sources – reached the Imperial Court of China in the second century A.D., bearing diplomatic credentials and also travelling via Southeast Asia.
This ancient calling of Rome - later extended to the whole of Italy - for Asia, has continued uninterrupted over time. Such as in the case, for example of the Venetian merchants, the most famous of which, Marco Polo, was in the service of the Mongols for a good sixteen years (1275-91). Another, the De Vilioni family, in Yangzhou, not far from Nanjing , was actively evolved in the fervent trade between Asia and China in the fourteenth century. The Florentine Giovanni da Empoli, a Renaissance man, served as an agent for Italian bankers and the Royal Court of Portugal. A true *ante litteram* manager in the seas of Southeast Asia, he stayed in Sumatra for a long time and eventually died in China in 1517.
Rome therefore represents the ideal stage for promoting initiatives aimed at developing mutual understanding. The Italian tradition since ancient times of trading and other entrepreneurial activities provided an opportunity for rich mutual awareness, which then spread to the rest of Europe and the world.

Which is the reason for the choice of Asia?

First of all, consider that in 2050 Europe's demographic weight in a global context will only be 6 percent, a figure which tells sufficiently of a process aimed at a more balanced distribution of global resources and potential. Against this background, Asia is one of the main players in the production system for overall wealth, having also adopted – in order to safeguard its own traditional values – some very fruitful western models for growth and development, such as, for example, the market economy system, the promotion of new technologies and widespread education. Added to this is the increasing geo-strategic importance of Asia, with the appearance of new world powers alongside emerging developing economies.
Asia, representing 30 percent of GDP, 33 percent of trade and 40 percent of global growth, is increasingly able to guide global governance and geo-strategic stability decisions.

What role can Italy play in this scenario?

Italy took over the half-yearly Presidency of the Council of the European Union on July 1. The Italian presidency will support the strengthening of the dialogue with Asia and all efforts will go into ensuring that progress in negotiations move forward with China for an agreement on investments and with Japan, Malaysia and Vietnam for free trade agreements. The presidency will also proceed with a view to resuming talks with Thailand as soon as the political conditions in the country allow and the start of negotiations with Indonesia, without which a free trade agreement between the EU and the Association of Southeast Asian Nations (ASEAN) cannot be reached. Our six-month presidency term will also provide an opportunity to promote the question of sustainable development in a European forum. It is a particularly important topic for our Asian partners.
Asia has, for some time, played a central role in Italian foreign policy, both on account of its growing geopolitical role in maintaining global equilibrium and for its economic dynamics, sources of opportunity for growth and business for Italian companies which have not yet been fully exploited. It is therefore not a coincidence that the medium-term goals also include substantially increasing Italian market shares in an area that still only represents 12 percent of our trade and 10 percent of our aggregate exports.
Asia is therefore an inescapable challenge for the Italian system and for Italian diplomacy. The Ministry of Foreign Affairs, in conjunction with other departments and, first and foremost, with the Ministry of Economic Development, has been committed for some time to developing and promoting new areas for Italian businesses in Asian markets, supporting the many complex processes of both internationalization and interaction between companies, science and university research.

ANDREA PERUGINI
Envoy. Since 2010 he has been Deputy Director General/Principal Director for Asia, Oceania and the Antarctica at the Directorate General for Global Affairs and Senior Official for Italy for ASEM and EU-ASEAN. Previously, Andrea Perugini held various important diplomatic posts: from 2008 to 2010 he was Italian Ambassador to Vietnam; from 2002 to 2004 he was Chargé d'affaires to the Permanent Representative of Italy at the OECD. From 1996 to 2000 he was Chargé d'affaires for the Economy and Trade to the Italian Ambassador in Beijing. From 1989 to 1996 he was First Secretary to the Permanent Representative at the Conference on Disarmament at the United Nations in Geneva.

What approaches will the Farnesina (Ministry of Foreign Affairs) and Italian diplomacy more generally employ toward the region?

Considering the complex nature and diversity of the Asian countries – which involves the types of society, economic dynamics, religious practices, cultural aspects – Italian diplomatic actions will follow a modular or flexible approach, commensurate with the situation and perspective of the individual countries, from time to time. Specifically, the Ministry of Foreign Affairs will foster the development of ongoing dialogue, on a bilateral and multilateral level, in order to establish all forms of collaboration, including economic, under the scope of wider and more stable political relations with the individual Asian countries. Recent strategic partnerships instituted by Italy, for example with China, In- →

donesia and Vietnam, demonstrate the aims of the specific diplomatic action of Farnesina.

What does this strategy consist of?

It involves a collection of activities to support Italian businesses, some large businesses, but especially small and medium ones, which are often those most exposed in the markets, to make them aware of the importance of the opportunities offered by extra-European markets. Specifically, the Ministry arranges and encourages political and entrepreneurial missions for this purpose, ensuring, among other things, the constant and extensive support of the Italian diplomatic and consular network.

Farnesina's efforts to promote economic and commercial trade in Asia are also being realized through political-contractual actions and initiatives intended to promote and facilitate meetings between entrepreneurs, in an attempt to remove or minimize impediments to economic cooperation and offer services to our entrepreneurs and their companies through our offices abroad.

Various actions have been undertaken, specifically in East Asia and Southeast Asia, including the following: the stipulation of agreements to avoid double taxation, thereby aiding investments and alleviating the burden of bureaucracy for our businesses, as in the recent cases of Hong Kong, Singapore and Taiwan; the supervision of trade negotiations conducted by the European Union for better protection of our excellent production chains and the interests of small and medium businesses; the creation of government support for companies producing systems and materials in the security and defense industry; the development of social security agreements, thereby reducing contribution costs for businesses whose workers are posted both in Italy and in Asia; the promotion of scientific-cultural agreements and scholarship programs for young people and students from the same countries; the granting of visas, which, in the case of some countries, like China, have recorded an annual increase of 25 percent, proof of the strong attraction of Italy (for its historical-artistic heritage, landscape and lifestyle) among the more affluent and emerging classes of many Asian countries. The 2015 Milan EXPO, to mention just one of the forthcoming events that Farnesina has worked very hard to promote, will undoubtedly be one of the most important showcases for revitalizing our economy, taking into consideration the participation of many Asian countries and the rich program of events centered mainly on food security and sustainable development.

Can we cite any particularly significant examples of collaboration with East Asian countries?

The rich variety of situations requires the continual involvement of Italian diplomats in the prospects of the individual countries. With Japan, to name but one example, our partner in the G8 and G20, we have, for some time, shared converging positions on a very wide range of regional and global issues, lately confirmed during the Prime Minister Shinzo Abe's visit to Rome on June 5. With regard to commercial trade, relations are also now on a far more even keel, and the potential for growth, which could further benefit the progress of trade negotiations initiated by the European Union with Tokyo, still exists. Against this background, it would appear essential for Italy to continue to monitor the situation closely in order to achieve the anticipated results. Our extremely profitable relations with Japan also benefit from the keen interest of the Japanese people in Italian art and culture. The availability of Japanese sponsorship resources has offered Italy the opportunity, on various occasions, to show the excellent nature of its culture, production system and Italian scientific networks. The success of the 2013 "Italy in Japan" event further consolidated ties with the country. The 150th Anniversary of Italian-Japanese diplomatic relations will be celebrated in 2016.

> Asia has taken on an important central role in Italian foreign policy, both on account of its growing geopolitical role in maintaining global equilibrium and its dynamic economies

Relations with China are also very profitable. There is a sectorial cooperation agreement in progress and an organized political dialogue that includes regional topics and the key issues of the global agenda. The Italy-China Governmental Committee, because it is overseen by both foreign ministries, is an effective tool for institutional coordination between the two countries, bringing together the public administrations of the two countries which are more actively involved in the practicalities of bilateral relations. A particularly significant shift in our relations with China lies in the visit of the President of the Council, Prime Minister Matteo Renzi, to Beijing and Shanghai from June 10 to 12. The meetings, held with the major Chinese leaders, including the President of the Republic, the Prime Minister and the Chairman of the National People's Congress, sealed and rubber stamped the joint political commitment for further development of bilateral cooperation. At the same time, the mission led to the renewal of the Italian-Chinese three-year plan of action for economic cooperation, the signing of an agreement between the Italian Ministry of Economic Development and the Chinese Ministry of Foreign Trade (for an increase in trade in the five priority areas -- environment, agriculture, sustainable urbanization, health and healthcare services, aeronautics/aerospace), the stipulation of other institutional agreements, the signing of a significant number of trade agreements and the inauguration of the newly-established Italy-China Business Forum (for dialogue and collaboration between the respective entrepreneurial systems). The main goals of our relations with Beijing include the gradual rebalancing of trade and the increase in Chinese investments in Italy.

With regard to South Korea, this year we are celebrating the 130th anniversary of diplomatic relations with a series of important meetings and events in the two countries, including a major economic Forum, which was held on June 5 in Milan, sealing the high level of cooperation and harmony achieved through bilateral relations over the years.

Italy and the EU are having a particularly intense dialogue with ASEAN. In April 2012, an ambitious five-year plan of action was adopted to increase collaboration

And how about Southeast Asia?

Farnesina's approach to Southeast Asia is an example of best practice, with multifaceted and complex actions having been developed over many years. This stems from the realization that, in redefining their international strategies, the countries of the area have undertaken a growing regional integration process over the last twenty years. This has come about mainly thanks to ASEAN (Association of the Southeast Asian Nations) an organization established in 1967 which, among other things, aims to gradually transform itself into an increasingly structured entity and to create a single market of the more than 580 million consumers from within its midst. Italy and the EU keep up a particularly strong dialogue with ASEAN. In April 2012, at the last EU-ASEAN ministerial meeting, an ambitious five-year plan of action was adopted to increase collaboration, extending it to the entire domain, from political and security issues to economic-commercial ones, from investments to social and cultural relations between the two areas. While the cooperation activities are progressing at a very satisfactory level, negotiations for an EU-ASEAN Free Trade Agreement (FTA) have been called off because of lack of progress, due to the strong imbalance of development within ASEAN. In the meantime, the EU is going ahead with negotiations for an FTA with individual ASEAN countries (signed with Singapore, negotiations in progress with Malaysia, Vietnam and Thailand), without giving up on the conclusion of an FTA in the future with ASEAN, once a critical mass of bilateral agreements has been reached. At the next ministerial meeting, we also intend to put forward a number of topics to the Asian countries, including: connectivity and infrastructures, non-traditional challenges to security, institution building, human rights, and the transfer of skills in the management of natural disasters. To improve economic collaboration further, in line with the already excellent political relations, the Foreign Minister has also launched initiatives aimed at familiarizing Italian businesses with the area. Specifically, in March 2012, in conjunction with "Confindustria" (Italian Employers' Federation) and the University of Rome Tor Vegata, the following new initiative was launched: the Asean Awareness Forum, in which representatives of the governments of the ASEAN countries and major global and regional financial institutions (IMF, World Bank, OECD, EU, Asian Development Bank) took part. It proved to be a very fruitful experience, and triggered further initiatives to facilitate direct contact between Italian entrepreneurs and their Asian counterparts. In this respect and on account of their innovative nature, we should also point out the recent web seminars on the markets of Indonesia and the Philippines, conceived and organized by Farnesina with the participation of ICE-Agenzia, Trade associations, Confindustria, Confartigianato and Unioncamere. Lastly, still in terms of bilateral relations with individual countries in the area, strategic partnerships are pretty significant, such as those mentioned previously with Indonesia and Vietnam, and the "Myanmar, the new Asian frontier" conference held at the Palazzo Farnesina in October with the two Ministries of Foreign Affairs taking part. Finally, the visit of the President of the European Council, Matteo Renzi, to Vietnam on June 9-10, the first ever by an Italian Prime Minister to that country, confirmed the priority Italy gives to this important emerging economy, as well as the production base for exports to the rest of Southeast Asia. On that occasion, President Renzi, who had meetings with his counterpart, the General Secretary of the Communist Party of Vietnam and the President of the Republic, announced the opening, next August, of the Italian Consulate Gen- →

ITALY–JAPAN MEETING
Rome, June 6, 2014. Italian premier Matteo Renzi (R) welcomes Japan premier Shinzo Abe (L) at Villa Doria Pamphili. Abe and Renzi, discussed, inter alia, the ongoing negotiations for a free trade agreement between Japan and the European Union.

eral in Ho Chi Minh City, the country's economic capital. The parties also agreed to hold within the year the first meeting of the Mixed Economic Commission, aimed at promoting trade and investments, as yet untapped resources.

The discovery of huge energy reserves (gas and oil) in Southeast Asian countries is definitely an important opportunity for the development of the local economies and, at the same time, represents a precious opportunity for attracting new investment aimed at guaranteeing energy efficiency, sustainability and security. What role can Italy play in this promising scenario?

Asian economies are expanding rapidly, with sectors such as infrastructures, manufacturing, new environmental technologies, telecommunications, the exploitation of raw materials, agriculture and tourism driving growth. The development of all these sectors not only requires a constant influx of foreign capital and know-how, but also involves an increase in the demand for energy. According to International Energy Agency data, since 1990 the demand for energy in Southeast Asia increased by two and a half times and forecasts from now until 2035 predict an increase of more than 80 percent, equivalent to current demand in Japan. For this reason, energy will play a key role in collaboration with Asia. Without energy there is no development. There is no modernization of agriculture, vital for releasing the potential offered by the combination of fertile land, abundant water and a favorable climate for farming. There is no industrialization and therefore integration into the global production circuit in sectors ranging from clothing to electronics, from footwear to the automotive industry. And, lastly, there is no improvement of living conditions and social progress.
According to the Southeast Energy Outlook of the International Energy Agency, within ASEAN countries almost a quarter of the population does not have access to electricity (with peaks of 66 percent in Cambodia and 51 percent in Myanmar), while half the population still uses traditional biomass fuel for cooking. It is therefore not only a question of providing the supplies for constructing electric power stations and new infrastructures like gas pipelines, oil pipelines and port terminals to receive the supplies, but also of guaranteeing access to energy for the largest number of people possible, through gas and electricity transmission and distribution networks, counting on sources which are efficient and have a low environmental impact. Italy and its entrepreneurial system can do a lot, thanks to its technology, leadership gained in various sectors of the energy and green growth industries, and the reliability for which it is renowned. This is true for the entire Italian production chain, which includes large businesses and small and medium businesses, alike. It is obvious that large companies have a more developed penetration gradient, for example in the recent case of Eni, which, over the last two years, was successful in tendering for hydrocarbon exploration blocks in Myanmar and Vietnam. Equally significant is the case of ENEL, which opened a representative office in Jakarta several years ago, following the acquisition of ten percent of one of the major Indonesian coal producers for electricity production, and then concluded supply agreements with various other prominent local producers. The rest of the industry, if adequately supported, can also improve its position and be awarded very profitable contracts.

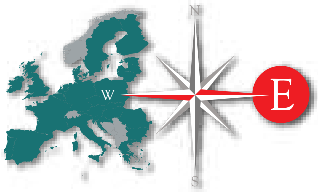
> In Southeast Asia the demand for energy will increase by more than 80 percent by 2035. It is energy that is likely to play the key role in collaboration with Asia

How do Italian actions fit into the wider European and multilateral context?

Italy, with the Ministry of Foreign Affairs in the forefront, contributes to the most effective coordination between EU member states, promoting a visible and united role for the EU in relations with strategic partners in Asia, not only for the essential stability of the area, but also to protect our geopolitical and economic interests as far as problems of a more general nature are concerned, such as, for example, maritime safety and free trade, the fight against terrorism and piracy, etc. It is the intention of the EU, and Italy as its intermediary, to take every opportunity to promote the peaceful and sustainable development of Asian partners, helping to reconcile or isolate tensions and disputes and foster growth without compromising the stability of the region. To give an idea of our dependence on the security of communications in Pacific Asia, just think that every year of the 22,000 merchant vessels that pass through the Strait of Malacca, approximately 2000 have Italian interests. It is for this reason that we support the commitment of the EU to better understanding the development of new regional equilibriums and to promoting stable collaboration relations with the major players in Asia, thereby encouraging all parties to effectively participate in the formal opportunities for dialogue already in progress between Europe and Asia and specifically the EU-ASEAN and ASEM Forums (Asia-Europe Meeting).

On the subject of ASEM, the next summit will be held in Italy, in Milan, on October 16-17. What does this opportunity mean for Italy, and what are the points of contact with the other big event in Milan, EXPO 2015?

ASEM, as an opportunity for dialogue and the planning of shared and mutual actions, is the true crux of the partnership between Europe and Asia. The fact that the next summit, which will be the tenth, of the Heads of State and Government of the ASEM countries will be held during the half-year term of the Italian presidency of the EU, is something unprecedented in Italy and of prime political importance for our country. Our proposal, suggested to the President of the European Council, Van Rompuy, of organizing the meeting on the subject of a "Responsible Partnership for Sustainable Growth and Security" stems from the shared need to focus on sustainable growth, a requirement which unites European and Asian countries, urging them to define and practice sustainable development, organized in terms of the economy, social issues and environmental equilibrium. The scheduling of this event in Milan will inevitably facilitate the content synergies and connections with EXPO 2015, with both of them obviously developing and dealing with topics and subjects which are rather similar: sustainable growth, climate change and energy. In conclusion, the overall theme of the ASEM summit is closely related to that of the Milan EXPO, dedicated to "Feeding the Planet, Energy for Life." In other words, both focus on specifically sustainable development, food security, water resources, new technologies for guaranteeing and protecting the "nourishment of the planet." The hope is that the high-profile participation and contribution of all our ASEM partners can further the success of such important events on the Italian international agenda.



Europe and Asia/Comparing geo-economic frameworks

Bridging the distance

Economic interdependence between Europe and Asia is ever increasing. But it is necessary, on both fronts, to guarantee the constant liberalization of trade and to provide incentives for domestic demand

by BENEDETTO DELLA VEDOVA

I am very pleased for this opportunity to open an event which I consider both timely and innovative. The idea of reconsidering "Eurasia" from different points of view, such as geo-economic framework and development models, investments in Asia and Europe, communication and diplomacy for growth seems in fact particularly appropriate in this time and place. The Italian Ministry of Foreign Affairs supported this initiative from the beginning, contributing to the development of its focus and assuring the full collaboration of its extensive network of embassies and consulates in securing the participation of the prestigious guests that are here with us today.

About the timing: Asia-Europe relations rank very high in both regions' agendas in 2014, with the focus on trade, business and investments expected to widen to include a stronger dialogue on security as well as a joint action to tackle 21st century challenges.

ITALY'S COMMITMENTS

As to its venue, Italy, this initiative is in line with the fact that our semester of presidency of the European Union is going to start in a few weeks. It will be a very challenging semester for Italy and for our Ministry of Foreign Affairs. 52 European and Asian leaders will gather in Milan on 16-17 October for the Asia-Europe Meeting (ASEM) Summit, with a view to fostering growth and development in the two regions and to consolidating dialogue on political-economic cooperation and socio-cultural exchanges.

Besides the Summit, another important event, the Asia-Europe Business Forum, is also scheduled to take place in Milan: it is expected to attract over 300 high-level high business representatives and CEOs, providing a unique opportunity to Asian and European business to network and exchange views on →

THE AUTHOR. Since February 28, 2014, Benedetto Della Vedova has been Under Secretary at the Italian Ministry of Foreign Affairs. In the 2013 political elections, he was elected to the Senate on the "With Monti for Italy" slate. He entered the Italian Parliament for the first time in April 2006 as a representative of the Chamber of Deputies. Previously, he was a representative of the European Parliament (July 1999 – July 2004).

economic and investment relations and to debate how best to meet today's challenges, while constituting a high level platform to engage constructively and concretely with political leaders from Europe and Asia.
Both the ASEM Summit in 2014 and EXPO Milan in 2015 will address fundamental issues for the countries of Eurasia, such as sustainable growth, food security, innovative technologies, water management, climate change and energy. We look forward to the high-profile contribution from all our partners to these most important international events that Italy is organizing.
Over the coming months, European and Asian policymakers, meeting within the ASEM framework, will discuss issues as diverse as sustainable development, green growth, enhancing peace and prosperity, human rights, education and urbanization. I wish to confirm Italy's increasing attention towards the consolidation of regional architectures in Asia, also to our role as the next EU Presidency. This comes along with intensive contacts between EU and the Association of the Southeast Asian Nations (ASEAN), which possibly represents in its own region the most dynamic actor in the context of regional architectures.
In this context, Italy is working to provide continuity to the ASEAN Awareness Forum held at the Ministry of Foreign Affairs in March 2012. We are planning to intensify our focus on ASEAN and its member countries during this phase of ASEAN evolution towards a single market and a more structured organization.
Working in tandem, Asia and Europe have enhanced strength. Taken together, they represent 58 percent of the world population and about 60 percent of world trade.

TRADE LIBERALIZATION

Increased Asia-Europe engagement is no surprise. For one, economic interdependence between the two regions is growing. As Asia's share of the global economy increases, Europe has naturally emerged as a leading economic partner, being the biggest source of foreign direct investment in the region.
Both Asia and Europe are bound by their search for strong, job-generat-

Two days for rei

1. East Asia: geo-economic structure and development models

YUANAN ZHANG

Rapid economic growth brings with it many challenges: great inequality, environmental sustainability, aging populations, and increased costs of labor and emigration. Recently, the twelfth five-year Chinese plan tried to provide an answer to these problems, especially targeting the development of services, introducing **MEASURES FOR ENVIRONMENTAL PROTECTION AND PUTTING THE BRAKES ON SOCIAL IMBALANCE**. I believe that these challenges also present opportunities. The Chinese government is demonstrating its desire to restore balance in economic growth, because the engine of investments that the Chinese economy was geared towards in the past has now reached its limit.

Foreign Editor, Caixin Media

GIUSEPPE IZZO

Over a period of fifty years, Taiwan has seen considerable socio-economic progress. While in 1952, its GDP was $1.7 billion, this figure had increased 250 fold to $484 billion by the end of 2013. Overall, European investment in Taiwan is more than $32 billion, equivalent to 25 percent of direct foreign investments in the country. Europeans recognize the strength and know-how of Taiwanese small and medium businesses, the **STRATEGIC GEOGRAPHIC POSITION OF TAIWAN IN THE ASIA-PACIFIC REGION**, its modern transport systems and excellent telecommunication infrastructures, as well as the stability of its institutions.

Chairman of the European Chamber of Commerce of Taiwan

IRMUUN DEMBEREL

The economy of Mongolia recorded double-digit growth over the last two years thanks to the recent development of the mining industry, in which a substantial part of our income is concentrated. We have coined a nickname for our country: **MINE-GOLIA**. We expect to export 50 tons of coal per year in 2016 and achieving this target will make us one of the major global exporters in the coal industry. Coal accounts for 27 percent of exports, copper 20 percent, iron ore and scrap 17 percent and gold 23 percent.

Invest Mongolia Agency

LAIXIANG SUN

The Chinese market has, in the space of a few years, become the main global market for exports, overtaking the United States and Germany by quite some distance. Chinese exports, however, are essentially different from German or Japanese exports, because many "made in China" goods are **PRODUCED IN CHINA BY FOREIGN COMPANIES**, and this is a vital element to take into consideration in terms of added value. China is also the market that recorded the fastest growth for imports from Europe: European exports to China have doubled over the last 5 years. Each year approximately 20 million Chinese acquire new affluence and develop tastes for many goods that were previously inaccessible.

Professor of Economic Geography in the Department of Geographical Sciences of the University of Maryland, United States

NAOYUKI YOSHINO

The new Prime Minister, Shinzō Abe, launched a political strategy based on the so-called **"THREE ARROWS" OF ABE**: an aggressive monetary policy, fiscal consolidation and economic growth. The Governor of the Bank of Japan, Haruiko Kuroda, undertook a monetary policy of quantitative and qualitative easing, which will continue until a precise inflation target is reached. Japanese public debt is very high, therefore we need fiscal consolidation and, in order to

ing, sustainable and inclusive growth. As such, both sides need to ensure continuing trade liberalization by fostering domestic demand and avoiding protectionism. The EU drive has coincided with Asian efforts to forge a free trade arrangement known as the Trans Pacific Partnership (TPP) and the Regional Comprehensive Economic Partnership (RCEP), linking all leading economies in Asia.
Asia and Europe also have a joint commitment to ensuring global stability and security by working to prevent conflict and tackling non-traditional security threats effectively at regional and global levels.
Europe can offer its expertise in regional integration, but also crisis management, conflict resolution and preventive diplomacy. In fact, the EU is developing broad security dialogues with many Asian countries focusing on issues like combating piracy, terrorism and cybercrime.
In comparison to any other geopolitical area, Asia is highly heterogeneous in institutional, economic, cultural, linguistic, religious or civil society terms. It's comprised of highly industrialized or post industrialized states, large emerging developing states with global ambitions, medium-sized states with the potential and ambition to grow, and finally struggling, less-developed countries. Hence, the need to take each and every chance to develop increased mutual knowledge and understanding.
In addition, awareness of the opportunities in the Asian region has not yet fully developed in the stakeholders within our national borders. In light of the above, I wish to thank the organizers of this workshop for their very important effort, which has received the "patronage" of the Ministry of Foreign Affairs in recognition of its valuable aim to increase such awareness and offer a presentation of the dynamic evolution of Asian economies.
We intend to inject new dynamism into Italy's image and role in Asia, and to represent ourselves on the Asian scene as a driving force. If we wish to interact better and better, all encompassing dialogue is essential, and this workshop is a skilful tool for our mutual knowledge and understanding.
Moreover, I am particularly pleased about this initiative, since it may be regarded as a best practice of cooperation between civil society and foreign affairs in promoting events aimed at raising awareness about the growing importance of Asia. The benefits are significant for us all, in terms of cost effectiveness and far reaching results in the relations with our Asian partners, and last but not least in terms of active support to our trade and business stakeholders in the framework of the strategy of the Italian Ministry of Foreign Affairs of "diplomacy for growth." ■

nventing the future

achieve it, we must postpone the retirement age and review performance-related compensation.

Professor of Economics of the University of Keio, Advisor to Prime Minister Abe, Dean of the Asian Development Bank, Tokyo Office

DAVID O'REAR

There are three factors which keep the East Asia stock exchange traders awake at night: economic stability, political stability and the rise of China as an economic, political, diplomatic, social and military power. There is **A GROWING FEELING OF UNEASE OVER THE INCREASE IN ECONOMIC DEPENDENCY ON CHINA**, which is also trying to expand territorially. Japan, Vietnam and the Philippines are seeking regional and international support against the claims of Beijing regarding islands, waters or other contended domains, and they are worried about the political and military interest of the United States in the region.

Chief Economist at the Hong Kong General Chamber of Commerce

GIUSEPPE SCOGNAMIGLIO

The emerging economies are no longer content with a growing economic role; they also want leadership and global influence. To give an example, I am thinking of the creation of the Contingency Reserve Arrangement, which offers a real alternative to world economic governance currently centered on the IMF and WTO. According to a *Financial Times* study into the **ALLOCATION OF WEALTH** globally from the 80s to the present day, between 1982 and 1987, only 31 percent of global growth was allocated to emerging countries; while from 2002 to 2012, the proportion was overturned with the figure for emerging countries reaching 67 percent. The forecast for the five-year period 2012-2017 is that this trend will continue, with the figure for emerging countries being 74 percent compared with 26 percent for advanced countries.

Head of Institutional and International Affairs, UniCredit

AJITH N. CABRAAL

If you observe the world economies you will notice that all those with the highest growth rates are in Asia. A recent study carried out by the Asian Development Bank categorically confirms that Asia has made the **GREATEST CONTRIBUTION TO THE GLOBAL GDP FOR ALMOST 1800 OF THE LAST 2000 YEARS**. It is only in the last 200 years that there has been a change in Europe and North America. The trend nowadays is in favor of Asia once again, which could recover and again make a contribution of over 50 percent to the GDP of the entire planet.

Governor of the Central Bank of Sri Lanka

HAN KI-WON

In 2013, Korea tripled the volume of its commercial activities, reaching $1 trillion. Until now we have used the route that passes through the Suez Canal for the transport of goods by sea from Korea to Europe. However, it is very likely that in future we could significantly reduce shipping times by using the **NORTH SEA ROUTE**. In this way we can save 7000 kilometers and 15 days travelling time. But that's not all. Once the Trans-Siberian railway, which will pass through the entire Eurasian continent, is completed, Korea will become the gateway from Asia to Europe.

Commissioner of Invest Korea

→

2. Invest in emerging markets, attract European capital

ANDREA GOLDSTEIN

2013 was an excellent year for European investment in the People's Republic of China. Many investors, including European ones, need the Chinese government to manage to strike a **BALANCE BETWEEN MARKET FORCES AND CENTRAL CONTROL**. The state should have less control over production and financial sources and more regulatory functions. It is particularly important to then manage to bring Chinese standards, rules and their application more in line with international procedures, creating a level playing field which goes in both directions: for European investors in China and for Chinese investors in Europe.

Head of Global Affairs, OECD investment division

NAOMI CHAKWIN

In 1992, the Asian Development Bank (ADB) launched the GMS program (Greater Mekong Sub-region), which involves the economic area defined by the natural boundary of the Mekong River, an area which extends for approximately 2.6 million square kilometers with a population of around 350 million. At the start of the project, we mainly concentrated on the construction of infrastructures for connection and transport, but we are now beginning to think about how to turn these roads into proper **ECONOMIC CORRIDORS** with support services, such as warehouses, refrigerating rooms and financial services.

Director of the Asian Bank for Development in Europe

XIN WEIHUA

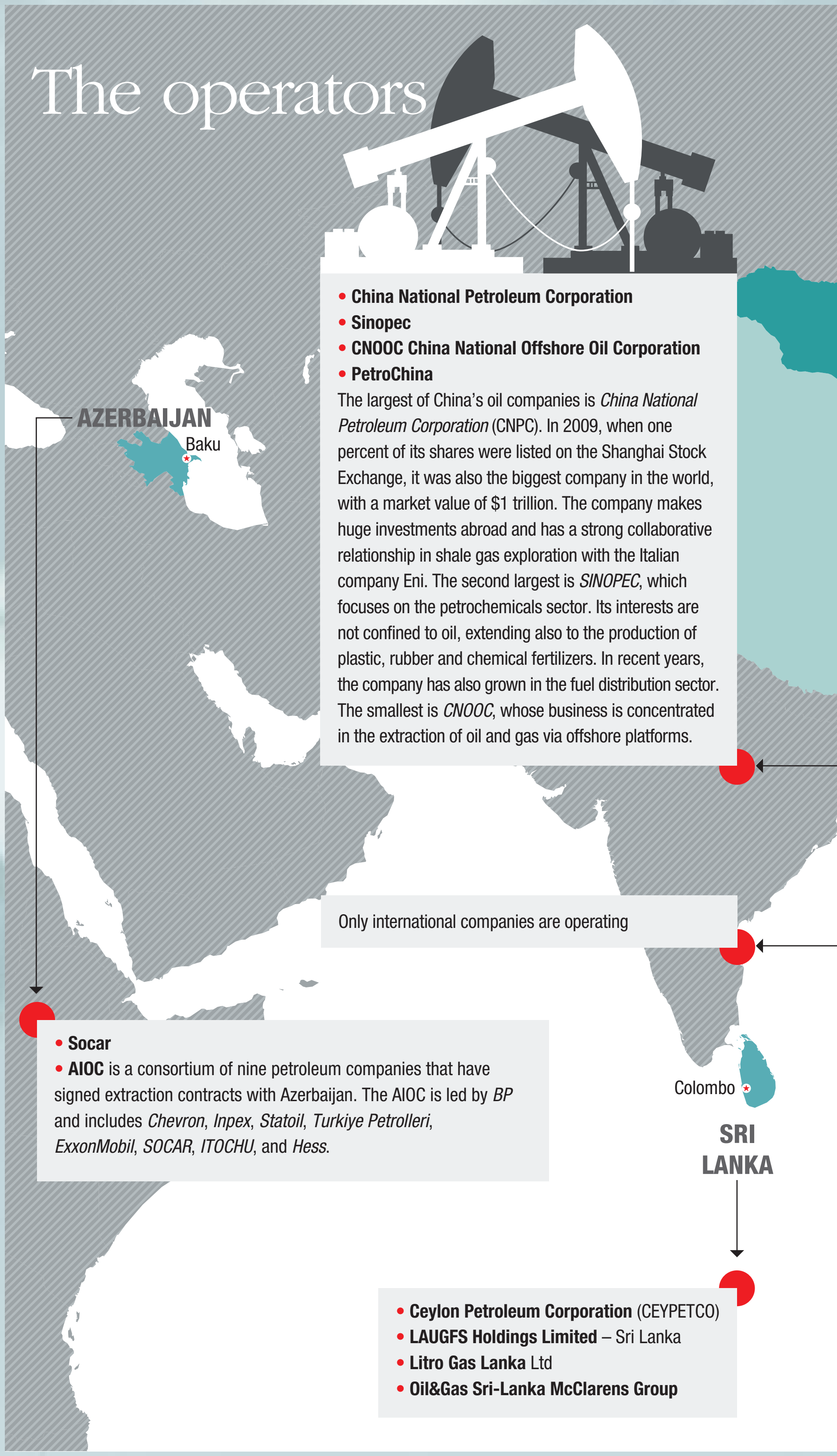
Diplomatic relations between China and Italy date back to 1970 and, as Confucius says, at forty there are no more doubts! I am convinced that in our relations the best is yet to come because there is a complementarity between China and Italy. **CHINA IS FINDING ITS WAY IN** domestic **INDUSTRIALIZATION**, making wholesale changes and becoming one of the major global markets. We have a great desire to collaborate with our European partners and we have already signed the 2020 China-EU strategic agenda, a document for cooperation that lays down the foundations for the further strengthening of this collaboration.

President, Shandong Wanbao Group Ltd.

WANG TAO

China and Europe are geographically remote, but our friendship goes back many centuries to the opening of the Silk Road. The records of Antoninus Pius show the first Roman Embassy in China opened in the year 166 A.D. Last year, the President Xi Jinping launched an appeal to build **AN ECONOMIC AREA ALONG THE SILK ROAD**, a new bridge between the East and the West. It is also necessary to expand Chinese investment sectors in Europe, promote infrastructures more and facilitate the settlement of Chinese businesses in the EU, simplifying the processes and guaranteeing them the necessary conditions.

Deputy Secretary General of the Euro-Asia Economic Forum

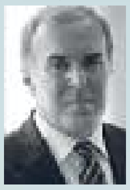


GUAN JIANZHONG

MULTIPOLAR RATINGS CRITERIA and multipolar ratings agencies are needed for a multipolar world. The current ratings system has a series of defects because it allows countries that are heavily in debt to obtain funding from global markets at low cost and with low interest rates simply on the basis of a good rating. The ratings criteria in the West only satisfy the requirements of western countries. A new, more balanced criterion should be introduced, which makes the agencies' ratings more reliable.

President, Dagong Global Credit Rating

VAQIF SADIQOF



The energy sector has historically been a key player in the development of the Azerbaijani economy since the beginning of the nineteenth century, when Azerbaijan was the first country in the world to start industrial development of oil fields. We have one of the largest offshore fields of oil and gas in the world, with sufficient proven reserves of hydrocarbon for more than 50 years. We currently produce approximately 50 million tons of oil per year, and 27 billion cubic meters of gas. These figures are more than enough to meet the needs of Azerbaijan; we are therefore developing our export programs and our infrastructures to **ALSO SUPPLY OIL AND GAS TO EUROPEAN AND GLOBAL MARKETS**.

Azerbaijani Ambassador to Rome

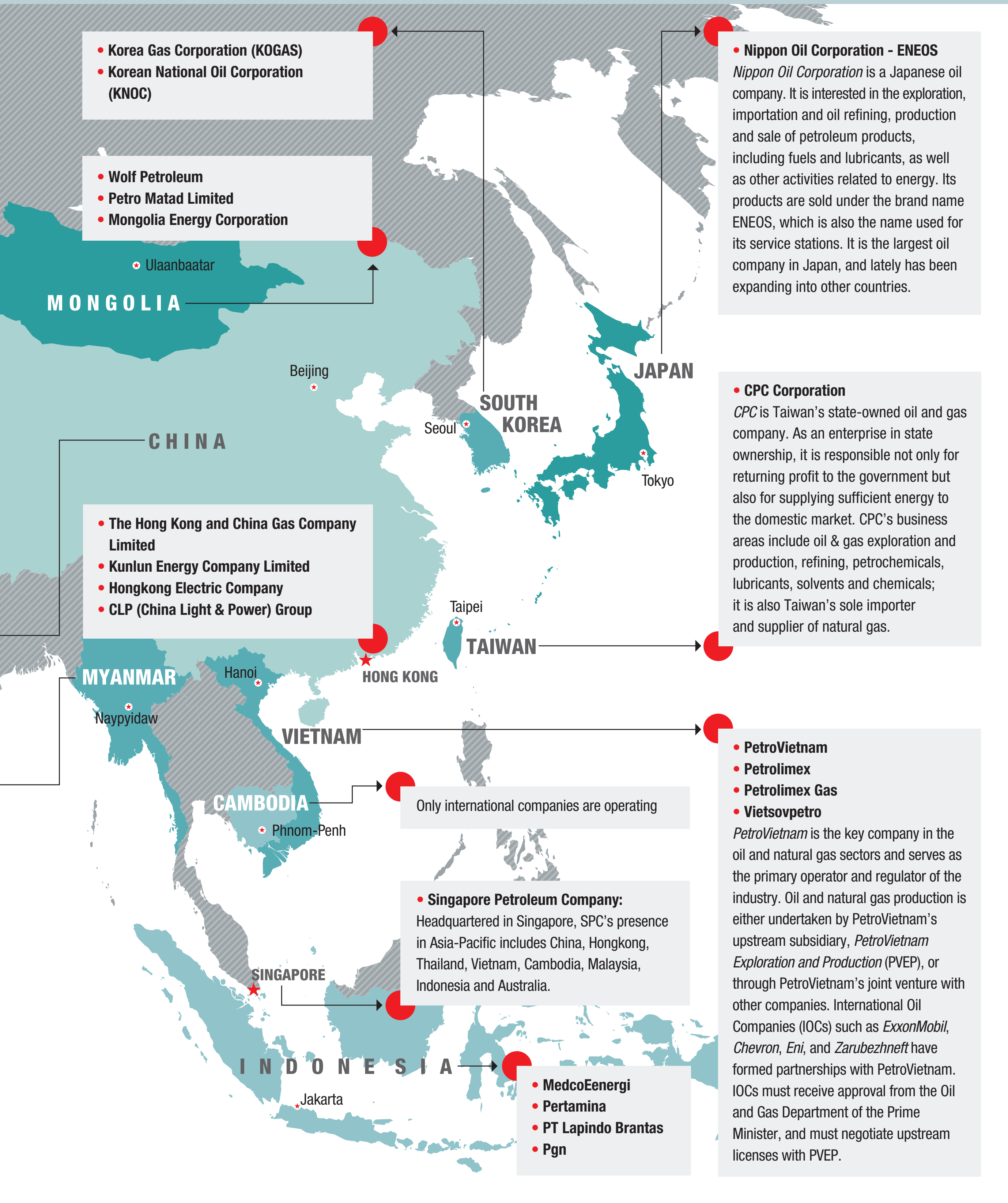
MASSIMO D'AIUTO

Simest is a financial institution that promotes the activities of Italian companies abroad. We want to be a **POINT OF REFERENCE FOR ITALIAN COMPANIES** for all aspects related to business development in international markets. We are specifically involved in three types of activity: investments in countries outside of the European Union, investments in Italy and other countries in the European Union and some public international investments. In Asia, up to now, we have actively invested in over 300 projects, spending almost €400 million.

CEO, SIMEST S.p.A.

THOMAS ROSENTHAL

What are the **MAIN REASONS DRIVING THE CHINESE TO COME TO ITALY**? Certainly there is an incentive to enter the country to gain free access to the Schengen markets. Another reason is definitely diversification of investment portfolios. However, what has brought the majority



of Chinese capital to Italy, has definitely been the desire to promote the industrial upgrading of the Chinese manufacturing sector. Many Chinese businesses were beating international competitors by leveraging low prices. Now, with the Yuan Renminbi having appreciated, the Chinese authorities need to increase production added value.

Director of the CeSIF (Centro studi Fondazione Italia Cina – Italy China Foundation Research Centre)

3. Europe and Asia: allies for growth

GIANNI DI GIOVANNI

Two thousand years ago, the Romans had a word for describing people who lived in the great stretch of the world that goes from India to China: "Seri," which comes from the Latin term for silk. Silk was actually the main commodity traded in that vast region. Contacts, at that time, were difficult; sending information was impossible. Nowadays, the lack of information is no longer a problem; on the contrary, we have an **EXCESS OF INFORMATION**. The problem is for readers to judge whether specific information is reliable or relevant. In this situation the media, once again, have a vital role in controlling, verifying and evaluating the objectivity, correctness and relevance of new information.

CEO of AGI (Agenzia Italia)

ALESSANDRO LANZA

Taking into consideration the ratio between the per capita GDP of the United Kingdom and that of China starting from the year 1000, it is noted that the maximum difference was recorded in 1965, when the per capita GDP of the United Kingdom was 16 times higher than that of China. Since 1965, the ratio has fallen very sharply. The current ratio is the same as it was in 1810. Therefore, **THE IDEA THAT CHINA OR INDIA ARE ADVANCING ON THE GLOBAL PLANE IS TOTALLY MISTAKEN**. The reality is that China and India are going backwards, because if you consider the 1820 GDP figures, they show that the share of China and India combined stood at around 50 percent of global GDP.

Oil editorial committee

LI LIFAN

China is currently having to reckon with a big problem, the production of excessive carbon dioxide in the process of modernization. We are trying to eliminate various types of polluting agents. We have not yet entirely succeeded, but we have launched a process for **CREATING A CLEANER SOCIETY**. I should like to stress that the Chinese are willing to collaborate with the Europeans in this sphere. We have just signed an agreement with Russia for the supply of gas worth $400 billion, to change our energy consumption habits. We have lots of ideas, and I know that some companies like Eni and ExxonMobil have a great deal of experience in technological innovations and the use of gas.

Executive Director of the Centre for Russian and Central Asian Studies, Shanghai Academy for Social Sciences (SASS), China

SOKMOM NIMUL

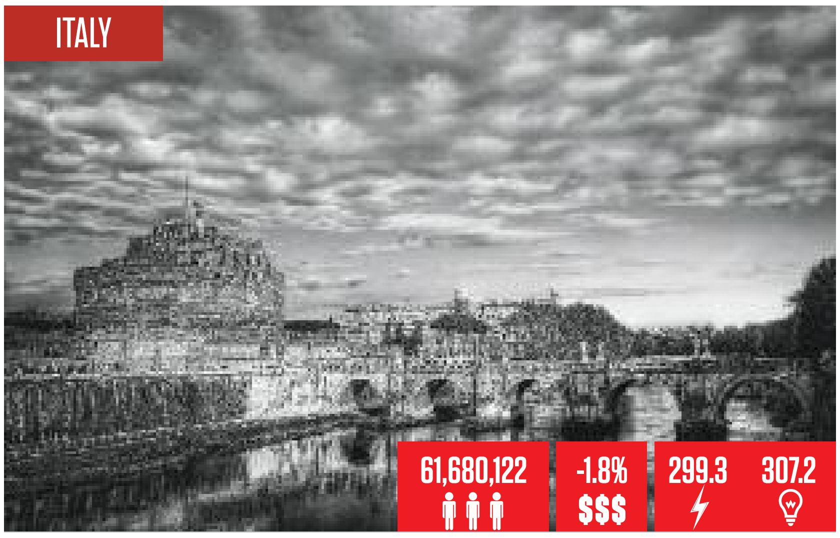
The AKP (Agence Kampuchea Presse), the government press agency, was established in December of 1920. Its task was to report on significant events taking place in the country and involve the entire population of the country. In March this year, AGI (Agenzia Italia) and AKP signed a memorandum of understanding on the exchange of information between the two press agencies, and we firmly believe that thanks to this agreement we will manage to **BRING THE PEOPLE OF THESE TWO COUNTRIES CLOSER TO ONE ANOTHER**, even if they are geographically and culturally remote and have very different traditions.

Director General, Agence Kampuchea Presse (AKP), Cambodia

Population | Electricity production in billion kWh | $$$ GDP - real growth rate | Power consumption in billion kWh

Source: CIA World Factbook 2014
For Oil & Gas data, source: Eni World & Gas Review

ITALY



Production: 105,000 barrels/day
Reserves: 599 million barrels as of December 31
Consumption: 1,310,000 barrels/day
Exports: 616,000 barrels/day

Production: 8.41 billion m^3
Reserves: 59 billion m^3 as of December 31
Consumption: 73.19 billion m^3
Exports: 0.14 billion m^3

AZERBAIJAN

Production: 915,000 barrels/day
Reserves: 7,000 million barrels as of December 31
Consumption: 86,000 barrels/day
Exports: 770,000 barrels/day

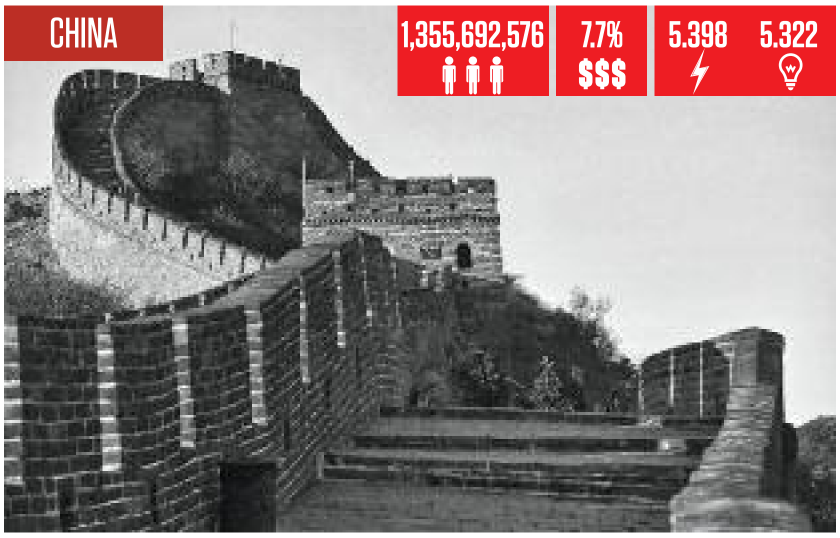
Production: 17.19 billion m^3
Reserves: 1,317 billion m^3 as of December 31
Consumption: 10.28 billion m^3
Exports: 6.33 billion m^3

CAMBODIA

Production: 0.5 billion barrels/day
Reserves: not available
Consumption: not available
Exports: not available

Production: not available
Reserves: not available
Consumption: not available
Exports: not available

CHINA



Production: 4,175 thousand barrels/day
Reserves: 25,585 million barrels as of December 31
Consumption: 9,600 thousand barrels/day
Exports: 608 thousand barrels/day

Production: 107.01 billion m^3
Reserves: 3,200 billion m^3 as of December 31
Consumption: 141.87 billion m^3
Exports: 2.85 billion m^3

NGUYEN DUC LOI

Asia and Europe are not only distant from a geographical point of view, they also have **MANY DIFFERENCES ON A HISTORICAL LEVEL**. There are religious differences, differences on a governmental level and in terms of development. These differences are the obstacle to cooperation and the process of connection. In order to achieve harmony, it is necessary to undertake a process to gain a new mutual awareness. Accepting shared values, respecting diversity. This is an important part of the media's role. In order to achieve this noble objective, we must analyze the information we produce and promote cooperation between media organizations in other regions.

Director General, Vietnam News Agency (VNA), Vietnam

YING WAN

Internet-related business in China is growing exponentially. Four out of ten of the major web companies in the world are Chinese. Social networks have also experienced explosive growth. **THE RECORD DEVELOPMENT AND EXTRAORDINARY SUCCESS OF THE NEW MEDIA** in China are due to various factors. According to official Chinese statistics, mobile users in China reached a share of 1.23 billion and the number of Internet users through mobile devices stood at 858 million at the end of last year. According to research into international trends, China has become the largest Internet market in the world, followed by the U.S.A., Germany, Brazil and Russia.

Director of International Communication Research China Daily

WANG XINGQIAO

If Xinhua wishes to keep pace with its competitors, both domestically and abroad, it must localize its services and contents as quickly as possible. For this reason it has recruited local workers, many of them Italian, American or Australian and people from other countries, who write the texts that accompany our photos and our videos. The teams recruited in various parts of Europe are involved with local news, providing readers with a faithful account of the various events happening in Europe. **BRIDGING THE GAPS**, the recipients of the news are less biased and less afraid of receiving a partial image of Europe.

Head of the Xinhua Rome office

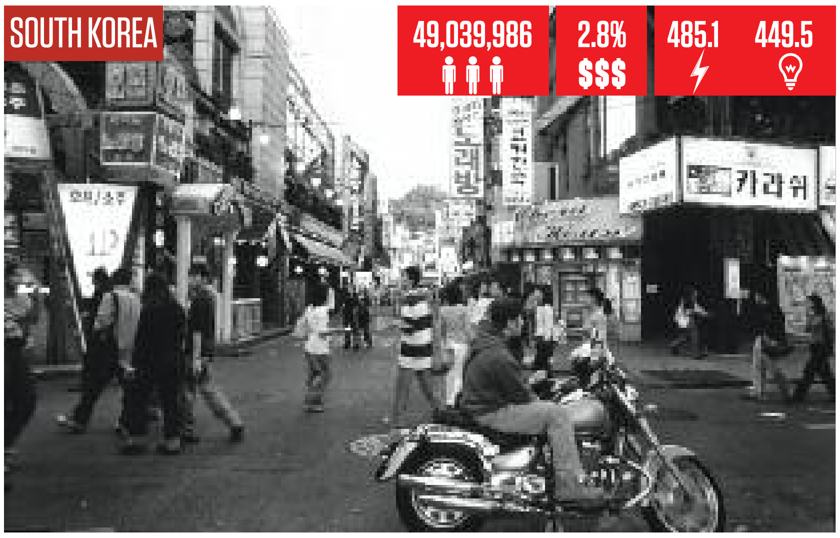
CHEN WEIHONG

The program that I host is called "Dialogue." I like this title because it creates a bond between people and countries, even when disagreements emerge. It is only possible to have a dialogue with others with an **OPEN MIND**. We have seen the opportunities that the Internet brings: in ten years, the companies that have made the best use of information tools are those that have achieved the greatest success.

Financial Channel Host, CCTV

Production: 890,000 barrels/day
Reserves: 4,030 million barrels as of December 31
Consumption: 1,541,000 barrels/day
Exports: 370,000 barrels/day

Production: 79.82 billion m³
Reserves: 2,919 billion m³ as of December 31
Consumption: 41.14 billion m³
Exports: 38.68 billion m³



Production: 21 thousand barrels/day (2012)
Reserves: not available
Consumption: 2,268 thousand barrels/day
Exports: 1,198 thousand barrels/day

Production: 0.47 billion m³
Reserves: 1 billion m³ as of December 31
Consumption: 53.65 billion m³
Exports: not available

4. Diplomacy for growth

ROMEO ORLANDI

ASEAN is less cogent than the European Union in terms of supranationality. The ten ASEAN countries remain independent, if anything, one of the cornerstones of ASEAN is precisely non-interference in a country's internal affairs. Extremely different socio-political situations co-exist within ASEAN. Every country has its own currency, religion, language and minorities. All of this is very sensitively handled by the governments of the ten countries and has been transformed into wealth, rather than a source of conflict. **ASEAN IS A PEACEFUL BLOCK**, where mediation of conflict is the most important thing. It is a block which, in spite of its diversity, is growing smoothly at a rate which, between 2000 and 2013, was over 5 percent.

Vice President of Osservatorio Asia

DIAUHARI ORATMANGUN

Indonesia is a member of the G20, the Organization of the Islamic Conference and the East Asia Summit. Lastly, we are actively involved in ASEAN. With regard to the latter, we believe the time has come to **NEGOTIATE AN ASEAN STATUTE**. In 2011 we agreed to establish an ASEAN community by 2015: an organization composed of a political and security community, an economic community and a socio-cultural community. But we have also learnt the lesson of the European Union. For the moment we are no longer talking about a single currency.

Indonesian Ambassador to Moscow and former Secretary General of ASEAN

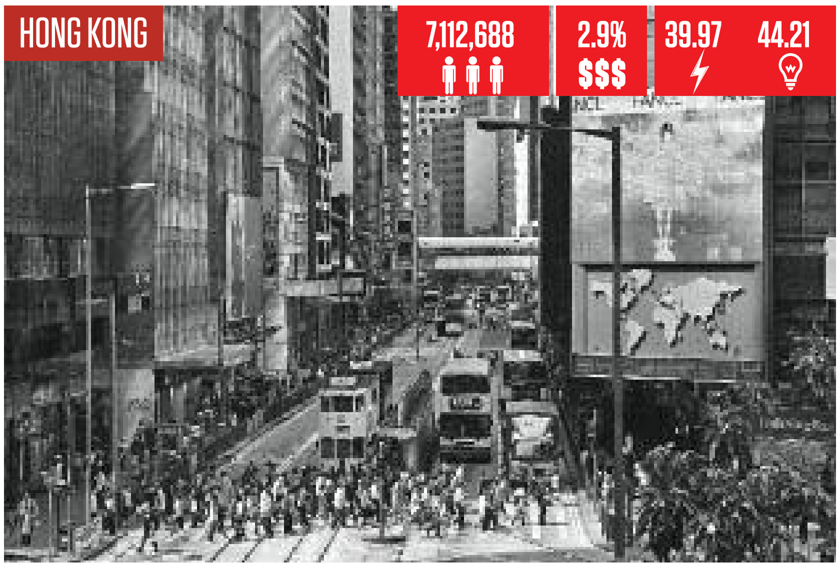
NGUYEN VU TUNG

Midway through the 80s, Vietnam launched a policy of opening its economy to the rest of the region and the world. Like other ASEAN countries, Vietnam initially was a growing market geared toward exports based on comparative advantages in terms of human and natural resources. Now, however, we are trying to focus on **STRUCTURAL CHANGES WITHIN OUR SYSTEM** to support growth, operating on four fronts. Firstly, guaranteeing peace and stability. Secondly, developing and maintaining an efficient financial, legal and economic system. Thirdly, relying on an effective education and training system and, fourthly, developing infrastructures, science and technology.

Director of the Vietnam Academy of Diplomacy, Ministry of Foreign Affairs

Production: 16 thousand barrels/day (2012)
Reserves: 44 million barrels as of 12/31
Consumption: 4,729 thousand barrels/day
Exports: 253 thousand barrels/day

Production: 3.64 billion m³
Reserves: 36 billion m³ as of December 31
Consumption: 125.47 billion m³
Exports: not available



Production: not available
Reserves: not available
Consumption: 380,000 barrels/day
Exports: 19,000 barrels/day

Production: not available
Reserves: not available
Consumption: 2.73 billion m³
Exports: not available

MONGOLIA

Production: 6 thousand barrels/day (2012)
Reserves: not available
Consumption: not available
Exports: 7 thousand barrels/day

Production: not available
Reserves: not available
Consumption: not available
Exports: not available

MYANMAR

Production: 17 thousand barrels/day
Reserves: 50 million barrels as of 12/31
Consumption: 29 thousand barrels/day
Exports: not available

Production: 11.92 billion m^3
Reserves: 509 billion m^3 as of December 31
Consumption: 1.77 billion m^3
Exports: 10.18 billion m^3

TAIWAN

Production: 0 thousand barrels/day
Reserves: 2 million barrels as of December 31
Consumption: 939,000 barrels/day
Exports: 343,000 barrels/day

Production: 0.40 billion m^3
Reserves: 69 billion m^3 as of December 31
Consumption: 18.55 billion m^3
Imports: 17.43 billion m^3

VIETNAM

Production: 356 thousand barrels/day
Reserves: 4,400 million barrels as of 12/31
Consumption: 413 thousand barrels/day
Exports: 218 thousand barrels/day

Production: 9.77 billion m^3
Reserves: 224 billion m^3 as of December 31
Consumption: 9.74 billion m^3
Exports: not available

ALICE CHOI

Hong Kong is strategically located in the south of China and at the heart of Asia. Our city has been classified by the Wall Street Journal as the most liberal economy in the world in the last twenty years. For every business in Hong Kong, **CEPA IS THE MAGIC WORD THAT ALLOWS ACCESS TO THE CHINESE MARKET**. CEPA (Closer Economic Partnership Arrangement) is the economic partnership agreement between China and Hong Kong that allows companies in Hong Kong to enjoy preferential access to the Chinese market beyond the definitions of the World Customs Organization (WCO).

Deputy Representative of the Hong Kong Economic and Trade Office in Brussels

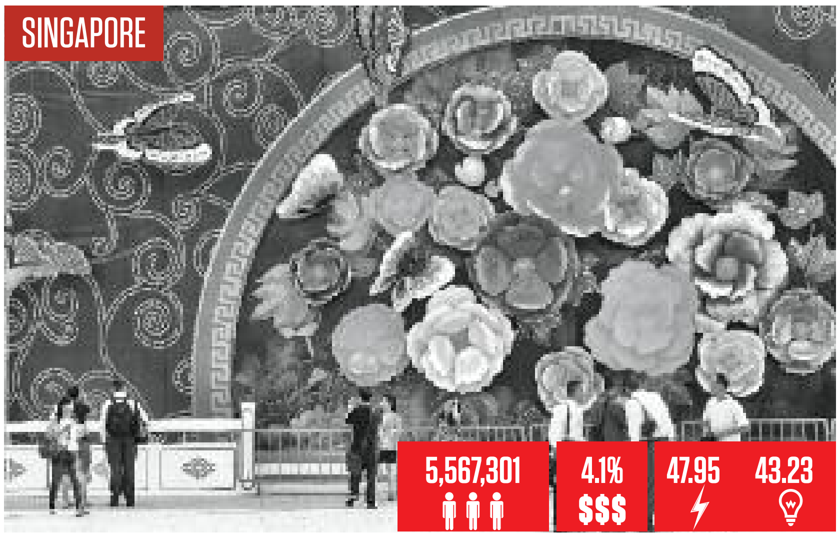
KHIN MAUNG WIN

Burma only recently opened its economy, but the pace of our political reforms has been notable. As far as energy and public services are concerned, our electricity capacity for a population of 60 million people is approximately 4000 MHz with 30 percent efficiency. The government does not possess the necessary resources to make investments, therefore **THE POTENTIAL IN THE ENERGY SECTOR IS ENORMOUS**. As far as hydraulic energy is concerned, we have an enormous potential of 100,000 Megawatts. We are also very careful about how our resources should be developed. Our experts are carefully examining all the possibilities, but we have encountered various obstacles with regard to extraction. I believe that European technology, your best practices and your companies, can be a part of the solution.

President of Myan Shwe Pyi Tractors Limited

AJITH N. CABRAAL

Sri Lanka is establishing itself as one of the safest countries in the world and we are currently **HEADING STRAIGHT FOR RECONCILIATION AND DEVELOPMENT**. Over the last 8 years, in spite of the conflicts that emerged, we recorded a 6.7 percent growth rate. In light of the recession that affected the rest of the world, this figure is very impressive. Inflation has remained under control. Our public debt has fallen significantly: only



Production: not available
Reserves: not available
Consumption: 1.295 thousand barrels/day
Exports: 1,083 thousand barrels/day

Production: not available
Reserves: not available
Consumption: 9.16 billion m³
Exports: not available

Production: 93 thousand barrels/day
Reserves: not available
Consumption: not available
Exports: not available

Production: not available
Reserves: not available
Consumption: not available
Exports: not available

12 years ago, it stood at 106 percent of GDP, but it has now fallen to 78 percent and is destined to decrease further.

Governor of the Central Bank of Sri Lanka

FEDERICO DONATO

Singapore is known by all for its strategic position; it is ranked the third country in the world in terms of per capita GDP and is a sovereign state with English as its national language. I believe that Singapore represents **A NATURAL CROSSROADS**, not only for Asia – I'd be lying if I said it - but also for Southeast Asia and the countries that form it. Just think of one figure: 62 percent of direct foreign investments from the European Union in the ASEAN area involve Singapore.

President of the Italian Chamber of Commerce in Singapore

DAVID WANG

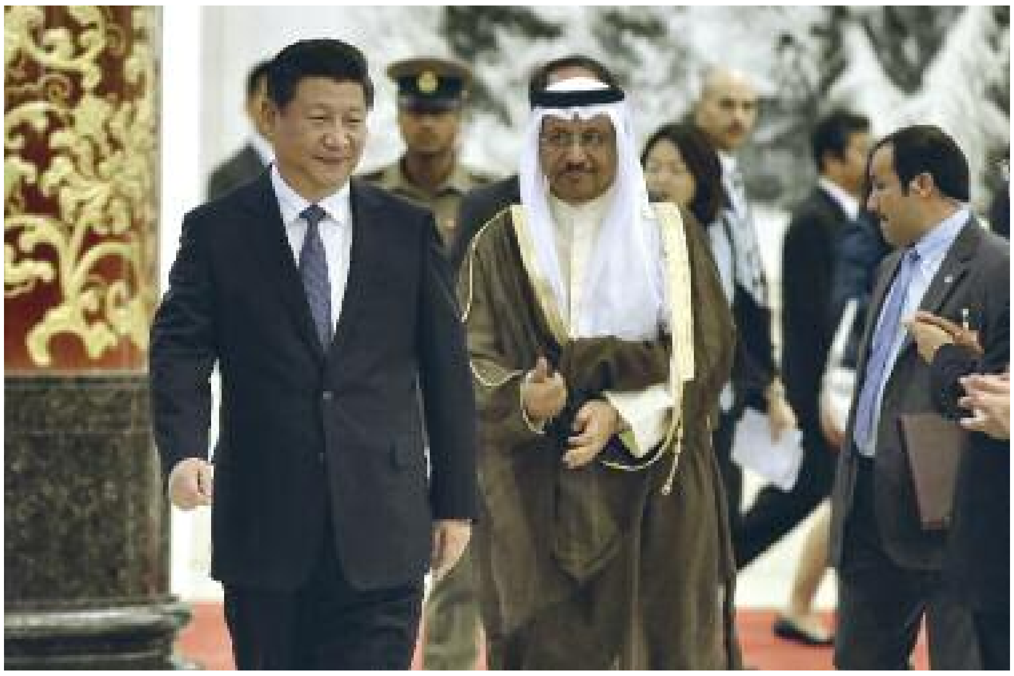
We are located in the middle of Asia. You can reach Taiwan from any country in Asia in 5 hours. However, we also have a population of 33 million inhabitants. Taiwan should therefore not simply be considered as **A GATEWAY TO ASIA**, but as a fairly large market. Taiwan is ranked at number twenty in the world in terms of economic size, while Italy is ranked at number eleven. We are richer than many countries in terms of per capita GDP: we are in twenty-eighth place in the world, ahead of the United Kingdom, Japan, France and Italy.

Director of the Economic Department, Taipei Representative Office in Italy

The spirit of the Silk Road in Sino-Arab relations

by DANIEL ATZORI

The Silk Road has returned. The age-old network of land and sea routes that used to connect the ancient world is coming back to life, and developing trade between two strategic areas, China and the Arab world, is at the center of this extraordinary transformation of the global economy.
The sixth ministerial meeting of the China-Arab States Cooperation Forum, which took place in Beijing on June 5, laid the foundations for further consolidation of relations between the two regions.
The Chinese President, Xi Jinping, the Chinese Foreign Minister, Wang Yi, and the Secretary General of the Arab League, Nabil al-Arabi, along with important representatives from Arab countries, took part in the event, which celebrated ten years of the Sino-Arab forum and provided an opportunity to discuss ideas and initiatives aimed at strengthening cooperation in future years.
President Xi Jinping invited China and the Arab countries to join efforts in the realization of "One Belt and One Road," which refers to the concept of the "Silk Road Economic Belt."
The Chinese believe the spirit of the Silk Road features peace and cooperation, creating a win-win situation among the partners. It is precisely in this context that Xi Jinping stated: "We want to achieve development for ourselves and we want to enable others to grow as well," also encouraging the building of a "community of shared interests and common destinies for China and Arab states."



Beijing, June 5. Chinese President Xi Jinping takes part in the opening ceremony of the sixth Sino-Arab cooperation Forum.

The concept of the Silk Road harks back to an ancient and glorious era of economic and cultural relations between these two regions

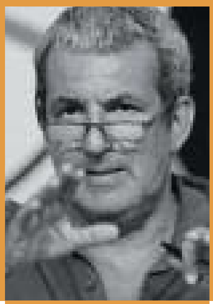
The original Silk Road began during the Han Dynasty, in the second century B.C. It involved a period of intercultural dialogue, during which the countries involved prospered greatly thanks to thriving trade. Economic indicators clearly show that the Silk Road is currently a very contemporary concept: the South-South Special published in May by HSBC entitled "What a globalizing China means for Africa and the Middle East," explores the fundamental importance of this relationship for the global economy. According to HSBC, "a globalizing China has been a primary catalyst for rising living standards," "for rapid infrastructure development," "for gains in industrial investment" in both the Middle East and Africa. In short, China is described as a real driving force behind growth in these two regions. Its very fast development is considered to be behind the "structural transition to a new era," a "transformation driven by China and fuelled by oil," which is having immense consequences on the economies and societies of the Middle East and Africa. Underpinning Sino-Arab economic relations, there is, naturally, China's need to guarantee a continuous and regular flow of energy for itself. Thus, the stability of the Middle Eastern region is vital for China's economic development, meaning that Beijing will increasingly seek to play a stabilizing role in the region. The concept of a "new Silk Road," proposed again at the Sino-Arab Cooperation Forum, appears precisely to allude to a more extensive and organic dimension of this relationship: a relationship, one should point out, not in opposition to European and American interests in the area. Indeed, the significant socio-economic development spurred by China, along with greater stability in the region, should benefit the entire world economy. A stable, peaceful Middle East with a growing economy would actually also provide a guarantee for the development and security of the west.

Relations between China and the Arab world can therefore no longer simply be reduced to Beijing's efforts to meet its energy requirements

The ever-increasing interdependence and integration between China and the Middle East is now obvious across disparate sectors. Chinese products are increasingly widespread, Chinese businesses are investing in infrastructure, Chinese banks are more and more active and Chinese tourism in the region is growing.
At the Sino-Arab forum, the President, Xi Jinping, stated that, in the next ten years the two parties will expand the volume of trade from the current \$240 billion to \$600 billion. Chinese companies have been invited to invest in Arab countries not only in the energy and petrochemical sector, but also in agriculture, manufacturing and services. All of this leads one to think that these dynamics are bound to intensify considerably in the years to come, and that China is destined to perform an increasingly important role in the Middle East, not only making an influential contribution to its economic development, but also, indirectly, to its political stability. ■

Daniel Atzori has been a Senior Researcher at the Fondazione Eni Enrico Mattei (FEEM), and he is currently Editorial Team Coordinator of the magazine *Papers of Dialogue*. Atzori earned his PhD in Government and International Affairs from the University of Durham (UK).

Communist turbo-capitalism is looking for new routes



by ANTONIO GALDO

The Chinese enigma is enshrined in the words of the economists at the World Bank. Describing in detail the slowdown in the country's economic growth, the Bank's Global Economic Outlook states that "if the Chinese braking were to turn into a hard landing, this would have negative effects throughout Asia."

The question mark hovering over the Chinese economy has broad implications for the future health of the entire Asian continent

China's slowdown has many aspects central to the action of the government, and all converge in the search for a new route for Communist turbo-capitalism. It's likely that any route chosen will feel entirely uphill and involve confronting a series of unknowns. First of all, the growth in credit needs to be cooled down, closely related to the fever that broke out in the property markets. And the country's gross domestic product (GDP) weighting needs to be rebalanced, as it is far too inclined to favor exports. But efforts to increase domestic consumption cannot ignore the average income of citizens and wealth per capita, and in general, a quality of life which, in current conditions, is even discouraging purchases. The news, already anticipated, of China overtaking the United States and destined, in 2014, to become the number one world power in terms of GDP (with purchasing power parity) caused an uproar. However, upon closer inspection, the figures reveal that the overtaking is virtual, not actual. Consider that the average income of an American citizen, at $51,000, remains nearly five times that of a Chinese citizen, at $11,000. And without an increase in income, first of all through an increase in salaries, it is difficult to make a breakthrough in domestic consumption. Up to now, Chinese turbo-capitalism has grown on the wave of low salaries, back-breaking shifts, and almost non-existent environmental and safety regulations in factories.
To turn the picture on its head, also taking the workers' claims into account, there is much more involved than searching for a new development model. It means rewriting the Chinese economic growth paradigms that we have recorded so far. Then there's the question of how to deal with the environmental disaster that accompanied Chinese growth. The level of pollution in large Chinese cities has become unsustainable: signs from the local authorities warning not to leave one's home are appearing with increasing frequency in Beijing. On the other hand, it would be impossible to do otherwise with peaks of 444 pollutant particles of 2.5 microns in diameter concentrated in a cubic meter of air. To put this into context, the World Health Organization classifies a level of 20 particles as air pollution, and that of 300 particles as a ceiling at which you should stay indoors.
Faced with this chronic environmental emergency, the Chinese government is beating a path for change, starting with a strong program of incentives designed to induce new car owners to buy electric cars.The goal is to reach 320,000 electric cars in circulation by 2015 and increase 2014 sales tenfold. But these are drops in the ocean of disaster. In this country that has allegedly overtaken the United States, 60 percent of water is not fit to drink and 20 percent of land is contaminated. In short, the price paid by Chinese turbo-capitalism is very high, and we have reached the day of reckoning, where change is not just necessary, but vital.

The proliferation of factories, which have inflated Chinese exports, took place within a system of total deregulation, protected and promoted by the Beijing authorities

For years, anyone could open a factory virtually how and when they wanted, without asking for a permit, and without giving any guarantees with regard to worker safety and environmental protection. Now things are changing, or at least trying to change. On January 1, 2015, a new law will radically change the system for new industrial areas. Authorizations and inspections will be needed to open a company (though one should not underestimate the degree of corruption – which is still very widespread) and businesses that violate the new rules can be closed down or seized. The Chinese Prime Minister, Li Keqiang, was very clear at the end of the last plenary session of the Chinese parliament: no holds will be barred in the struggle against pollution.
The medium-term objectives of the Chinese government include the repositioning of the current energy mix of the country. Currently, energy consumption in China comes 68.5 percent from coal (highly polluting), 18.6 percent from oil, 6.5 percent from hydroelectric power, 5.0 percent from gas, 0.8 percent from nuclear power and 0.7 percent from wind power. The new targets, set for 2020, include a reduction in consumption from coal to 52 percent, an increase in oil to 20 percent, gas to 12 percent and hydroelectric power to 9.1 percent. Wind power, even if it is expanding greatly, still remains marginal at 2.5 percent and nuclear power soars to 3.2 percent.
In preparing for the energy turning point, China has already set out its goal posts on the international chessboard. The maxi agreement with Vladimir Putin's Russia, signed in May, guarantees Beijing supplies of 38 billion cubic meters of gas per year. And in Iraq, taking advantage of the American military withdrawal in an area that has become a powder keg for the advance of the Jihadist militias, the Beijing government has staked its claim on the rich deposits of oil (Iraqi oil reserves stand at 145 billion barrels and are the second largest after those of Saudi Arabia). Iraq has therefore become the fifth largest supplier of oil to Beijing, and exports from Baghdad to China have increased by 50 percent in 2013 alone.
The solution of the Chinese enigma, decisive for the whole of Asia, passes through here as well: through a new geopolitical strategy, before the economic one, on energy supplies – those that can make a difference along the road of a new development model. ■

Antonio Galdo recently published *L'egoismo è finito* (Einaudi) and runs the website www.nonsprecare.it

IAI
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Energy and the balance of power in Asia

by NICOLÒ SARTORI

Thanks to a sudden increase in energy demand, driven by strong economic performances showing no signs of slowing down, East Asia is gradually becoming one of the mainstays of the global energy system. The International Energy Agency (IEA) data speak for itself: the region will make a 63 percent contribution to the growth in global energy demand from now until 2035. In total, Asian demand should increase by almost 14 million barrels of oil per day and by 680 billion cubic meters of gas over the next twenty years.
In this context, China and the Asian tigers are frantically trying to expand and diversify their energy portfolio, while Russia – also by virtue of events in Ukraine – is looking for new markets for its resources, precisely in Asia. The United States completes the picture, ready to consolidate its role offering its Asian allies energy cooperation in exchange for military support under the scope of a complex regional power play.

Dung Quat, the first oil refinery in Vietnam, in the Quang Ngai Province. The race to develop energy resources has fuelled growing tensions between Vietnam and China.

On the strength of its military and economic superiority, China is becoming increasingly assertive in the region

The search for new sources of procurement by regional protagonists plays an important role in Asia's security dynamics,, particularly in the areas of the China Sea, a crucial juncture for the transit of hydrocarbons to Asian markets. Every year, approximately one third of global oil traffic and half of that for liquefied natural gas (LNG), coming mainly from the Persian Gulf and from Africa, passes through the energy artery of the China Sea, as does a large part of the inter-regional trade in oil and oil products.
Increasing attention has also been dedicated to exploration and production activities. According to the estimates of the American Energy Information Administration (EIA), huge deposits of hydrocarbons could be located in the southern part of the China Sea, amounting to approximately 11 billion barrels of oil and 5.5-6 trillion cubic meters of gas. The race to develop these resources is fuelling growing tensions between regional players as a result of the uncertainty over the territorial sovereignty of the area. Buoyed by its economic, political and military superiority, China is becoming increasingly assertive, as demonstrated by its recent unilateral decision to start exploration activities in waters also claimed by the Vietnamese government. Military spending in the region confirms the worsening of relations between the countries involved in the territorial disputes, which, in addition to China and Vietnam, include Brunei, the Philippines, Indonesia, Malaysia and Taiwan. According to SIPRI (Stockholm International Peace Research Institute), between 2008 and 2012 Asia was the number one area in the world for the transfer of armaments. In the period under consideration, sales to Southeast Asian countries tripled compared with the previous four-year period, driven by purchases of warships and naval equipment, as well as aerial capabilities with maritime applications.

The Russian government has ambitious diversification plans with regard to Asian markets

Russia looks to the East with great interest, and it could not be otherwise by virtue of regional energy trends. Last January, even before the worsening of the crisis in Ukraine and the cooling of relations with European partners, Russia's Energy Minister presented ambitious diversification plans with regard to Asian markets. The Kremlin's objective is to expand sales of oil and gas to Asia to more than 30% of total exports. If Russia's presence in the oil market is already consolidated, thanks to exports exceeding one million barrels per day, it is in the natural gas sector that most of Moscow's new energy game in Asia will be played out.
Indeed, Russia only exports 15 billion cubic meters of gas to Asia, approximately 3 percent of its total production, through the Sakhalin II LNG terminal. The reference markets are Japan and South Korea, while exports to China (and other countries in the region like Taiwan) are still limited. However, the picture is rapidly changing, thanks to the recent agreement signed by Gazprom and China National Petroleum Corporation (CNPC) for the supply of 38 billion cubic meters (bcm) of gas annually for 30 years, and other initiatives involving Russian energy companies.
The new pioneers include the independent company Novatek, which, together with Total and CNPC launched the Yamal LNG project, with the gas planned to reach Asian consumers from 2017. Rosneft, the giant government-owned oil company, also showed its desire to expand its sales in Asia, challenging Gazprom, which has a monopoly on exports via pipelines. Towards that end, the company, led by Igor Sechin, managed to get authorization to export LNG through its terminal being built in the Far East.

The Americans are not sitting back

With China in the throes of expansion and Russia increasingly active in the region thanks to the prospects of energy cooperation, the United States can't stand by idly.
In reality, since the beginning of its term, the Obama administration has, through its Pivot to Asia policy, stressed the need to concentrate American military forces in Asia to deal with the growing Chinese threat in the region. Historically, the United States has guaranteed the area's geopolitical equilibrium and safeguarded the strategic interests of its Asian partners – first and foremost Japan and South Korea– through the protection of energy procurement routes from Africa and from the Persian Gulf. In this context, the naval reinforcements initiated by Beijing represent a threat to the traditional role of the United States as guardian. The American government is expecting greater collaboration from Asian allies in confronting Chinese aggression, and is asking for operational support and cost sharing. To offset this, the United States can offer cooperation in the energy sector, made possible by the expansion of American non-conventional production. Strategic calculations, in addition to price dynamics, therefore explain the all clear from the Department of Energy for exports of American LNG to Korea and Japan, while requests for authorization to export to China still remain under the magnifying glass of Washington officials. ■

Nicolò Sartori is a researcher in the Security and Defense Department at the Istituto Affari Internazionali [Institute of Foreign Affairs] in Rome, with a special focus on the evolution of technologies characteristic of the energy industry.

THE U.S.A. HAS BECOME THE NUMBER ONE GLOBAL CRUDE OIL PRODUCER

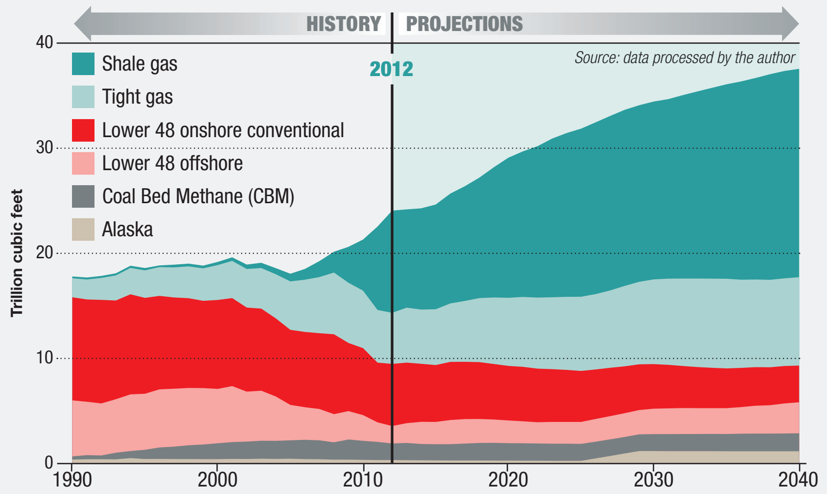
A victim of its own success

The boom in North American oil and gas production following the introduction of hydraulic fracturing has led to economic, logistical and environmental difficulties

by JAMES HANSEN

The Barcelona daily *La Vanguardia* recently reported the story of Pyros, a brown bear facing castration by Spanish conservationists. Why this rather putinitive treatment? It seems Pyros was too successful at reproduction, keeping all potential mates for himself. Scientists working to reintroduce the species in the Pyrenees Mountains, where it had gone nearly extinct, have shown through DNA that Pyros is the father, grandfather or great-grandfather of nearly every cub born in the area in the last twenty years This inbreeding has had devestating results on the bear colony.

U.S. NATURAL GAS PRODUCTION BY SOURCE



There has been a boom in gas production since 2010, mainly due to shale gas and tight oil. Projections to 2040 show how most of the further predicted increase will come from unconventional sources.

Success brings problems, and extraordinary success can breed huge problems

The remarkable boom in North American petroleum production following the introduction of hydraulic fracturing, or "fracking," is well known. As has been widely reported, the U.S. Government has now begun dismantling export controls on unrefined petroleum products after a suspension of forty years. Production has skyrocketed as a result.
U.S. oil production shot up to 8.4 million barrels a day, an increase of 16 percent over last year. According to some estimates, the U.S. has already overtaken Saudi Arabia as the world's largest oil producer, a result that until recently would have been unthinkable. However, the production boom is now facing a range of problems growing out of its very success.
These run from the objections of environmentalists, who had seen scarce energy as a way to curb the excesses of a consumerist public, to those in capital markets worrying about possible over-investment in the sector and logistic and regulatory bottlenecks. Finally, concerns abound about an impending and possibly chronic labor shortage in the processing and refining industries.
This last problem is already being felt sharply in Texas and Louisiana, where the demand for skilled workers for the processing and refining industries is causing cost overruns and delays, threatening to slow the boom.
According to a survey by the Greater Houston Port Bureau, $35 billion will be spent on expansion projects along the Houston Ship Channel by next year, creating 265,800 new jobs. In Louisiana, where $60 billion in building projects are planned through 2016, the State labor commission estimates 86,300 new workers will be needed. The biggest shortages are for specialized personnel like welders, electricians and instrumentation technicians. Skilled welders on the Gulf Coast earn up to $35 an hour, and wages are growing at an estimated twelve percent a year.
Chevron Phillips Chemical Co. recently found that construction budgets on ethylene and polyethylene plastics plants being built near Houston will exceed the original $5 billion estimate by $1 billion, mostly because of increased labor costs according to CEO Peter Cella. "Where are the workers going to come from?" he asked journalists.

The industry is highly capital intensive and money is short

According to a Bloomberg News analysis of 61 operators, shale debt has almost doubled over the last four years - reaching $163.6 billion in the first quarter of this year - while revenue has increased just 5.6 percent.
"The list of companies that are financially stressed is considerable," Benjamin Dell, of Kimmeridge Energy, a New York-based energy asset manager, told the agency. "Not everyone is going to survive," he said.
Once again, much of the difficulty arises from the sector's success in expanding production. Greater supply has caused North American natural gas prices to fall. At the same time, producers must keep borrowing to pay for exploration to offset the steep production declines typical of shale wells.

Logistics is another headache. The amount of crude oil transported by rail has increased 50% since 2012,

challenging capacity and causing worries about safety.
Rapid growth in North Dakota's crude production - most of it carried by rail – has contributed significantly to the U.S. energy boom. But crude from the state's Bakken Shale formation turns out to contain several times the combustible gases of other oil.
Federal investigators are now trying to determine whether these vapors are responsible for recent explosions of oil-filled railcars, including one that killed several dozen people in Canada last July. The volatility of Bakken crude raises concerns about dangerous cargos moving through populated zones, and there have been calls to slow oil convoys and to redirect them around high-risk areas. These pressures place new limits on rail transport that could block the growth of output. The problem is particularly pressing because of popular resistance to the construction of new pipelines that could reduce the load on the rail system. Work on the Keystone XL pipeline, intended to carry petroleum extracted from Canada's Alberta tar sands to destinations in the US Midwest, has been blocked for five years over environmental objections.
Similar problems sharply limit American export capacity with regard to liquified natural gas (LNG).
The country lacks facilities to handle the traffic because there was little gas to export until recently. Of 31 requests for licenses to construct LNG export terminals, just six have been approved and only one - at Lake Charles, Louisiana - has received the final go-ahead from the US Federal Energy Regulatory Commission (FERC).
It should go online in 2015.
Despite common perceptions, environmental objections - though they certainly contribute to regulatory difficulties - actually seem to be among the lesser challenges to the fracking boom. The biggest concerns are related to water consumption - especially in arid states like California and Texas - and the possible contamination of groundwater, as well as the escape of free methane - a "greenhouse gas" - into the atmosphere during drilling and extraction. Still, at the end of the day, most nations would gladly face the new problems brought about by the fracking boom in the United States if the choice is between having too much energy or not enough.

James Hansen provides financial reporting and international relations consulting to major Italian companies. He came to Italy as the U.S. Vice-Consul in charge of economic affairs at the U.S. Consulate General in Naples. He became a correspondent for various leading foreign press organizations, including the *International Herald Tribune*. Then he was appointed spokesman for Carlo De Benedetti, Silvio Berlusconi and, finally, head of the press office of Telecom Italy.

MARKET TRENDS

The unstable equilibrium of Brent

New geopolitical fronts renew tensions over price, but they will be short-lived

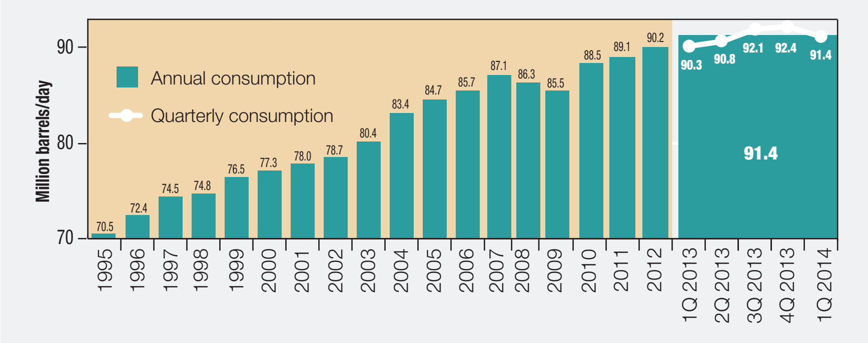
Oil prices

The first half-year of 2014 closed with the average price of Brent at $108.9 per barrel, reconfirming levels observed in 2013 and recording the lowest volatility rate of the last 20 years. The market continues to move in the shadow of moderate demand and a macroeconomic situation displaying contradictory trends. Recently, the Asia Pacific area showed signs of a slowdown after the exceptional growth rates of recent years. Sporadic peaks, above the acceptable threshold of $110 per barrel, occur in response to political crises or the opening up of new frontiers: the Ukraine crisis in March and the more recent Iraqi crisis are the two hottest events in this part of the year. The situation in Ukraine, with the exception of a brief spike in the first days of March, did not have significant repercussions for the price of Brent: the flow of Russian crude oil to Europe via Ukraine (0.3 million of barrels per day (Mb/d)) was not at risk.
In Iraq, on the other hand, there were fears of adverse affects on exports from the south of the country (Basra), which is currently the only exit route for Iraqi crude oil, following the interruption, from the start of March, of the Kirkuk Ceyhan pipeline (in north Iraq) at the hands of the rebels. In the middle of June, the rapid advance from the northern regions of the Islamic extremist group ISIS (the Islamic State of Iraq and Syria), which captured Mosul, the second largest city in the country, and the Baiji refinery, rapidly pushed the price up to the highest level for the year ($115 per barrel). The rebels currently control approximately one third of the country, including exports from the north. The markets' main concern relates to the potential spread of the conflict to the south, where giant projects and approximately 85 percent of production are concentrated. The end of the alarm, at least apparently, has immediately restored the price to previous levels, even if the chaos into which the country has been plunged shows the force of sectarianism and the precariousness of the current government and casts serious doubts about the future of one of the key countries counted on for growth in global supplies.
Procurement for the market, however, remains positive. The loss of supply in the world's various hot spots (Libya, Yemen, Sudan, Syria, Iran, Iraq) has been balanced by the unexpected growth on the North American front, which sees the U.S. in pole position with an increase of approximately 1 Mb/d a year. Away from North America, crude oil production has gone down by approximately 2 Mb/d since 2010. The market has also adapted to geopolitical cutbacks through a process of replacing missing oil with alternative crude oils, many of which have become more available thanks to the collapse of U.S. imports: West Africa oils, blown away by tight oil, those from South America blown away by the increasing volumes from Canada, have found alternative routes in European and Asian markets.
In this context of rebalancing volumes in the physical market, where the trade in products has also recorded new flows – increased exports from Asia and from the U.S. – the market has already taken into account the risk of socio-political instability in many oil-producing countries. Oil prices tend to stabilize at around $110 per barrel and volatility remains low, even if volumes in the futures market continue to create new records. The "risk" business is restrained by new anti-speculation regulations and production capacities are actually higher than even the most optimistic growth predictions for demand. No one expects oil shocks capable of moving the market out of current price levels, but one is mindful that stability is tenuous.

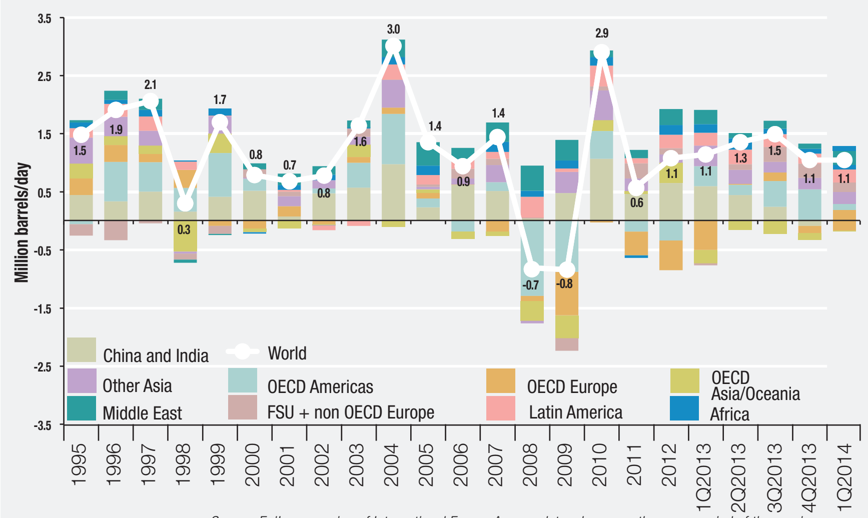
Oil demand

In the first quarter of 2014, global oil demand reached 91.4 Mb/d, an increase of 1.1 Mb/d compared with the first quarter of 2013. Non-OECD countries were confirmed as the driving force behind this increase, while the fall, albeit slight, in demand from OECD countries continued. North America, specifically the U.S., is an exception among industrialized countries, with a rise of 0.1 Mb/d. The particularly harsh winter sustained energy consumption, and lower prices at the pumps encouraged the use of private vehicles in spite of the severe weather. In Europe in Q12014, demand continued to fall (-0.2 Mb/d) as a result of the mild winter and the fall in fuel consumption, with the exception of the U.K. and Germany.
The Middle East replaced China as the area of greatest growth in demand for oil, contributing to approximately one quarter of the global increase (+0.3 Mb/d) in the quarter. Middle East consumption was supported by the maintaining of subsidy policies for final fuel prices and a high use of oil in electricity generation.
In China, the slowdown in economic growth and industrial production was reflected in a lower consumption growth rate. In addition, the interventions of the Chinese government aimed at containing the high levels of pollution in urban areas have been having a discouraging effect on diesel consumption, the fuel used for commercial transport. The unstoppable development of Chinese motor vehicles continues, however, to support gasoline consumption; in the first 5 months of 2014 approximately 10 million cars were sold, a 10 percent increase over the same period in the previous year.
In India, positive growth rates were recorded for the second consecutive quarter in demand for oil, after a slowdown in the second and third quarters of 2013. Gasoline and liquefied petroleum gas (LPG) consumption are balancing out the reduction in diesel fuel, a product greatly penalized by the gradual reduction in subsidies.

TOTAL GLOBAL CONSUMPTION

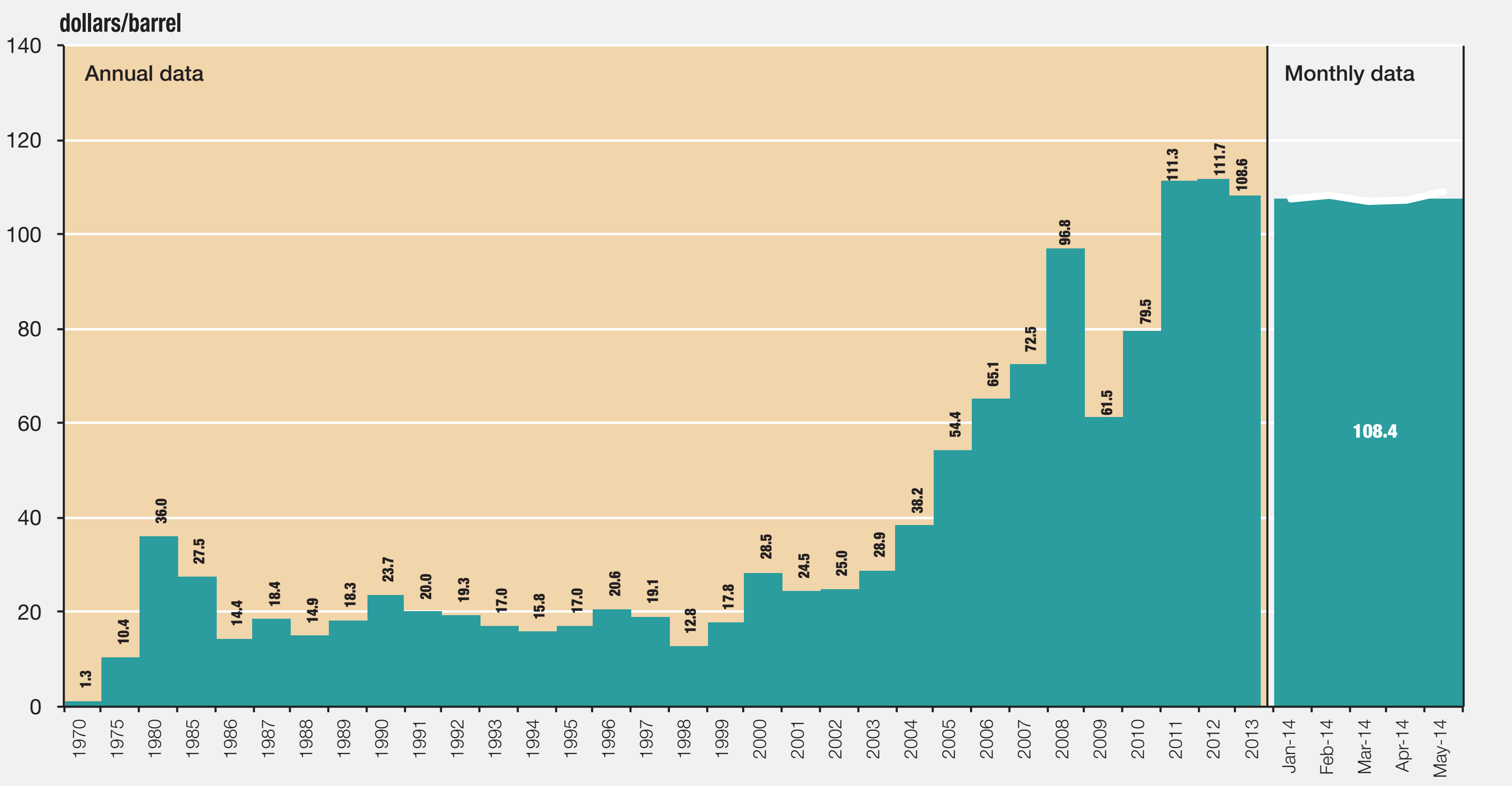


CHANGE IN TOTAL GLOBAL CONSUMPTION BY AREA



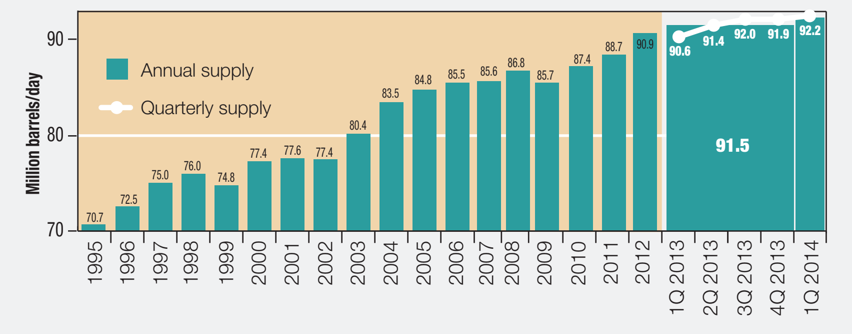
Source: Eni's processing of International Energy Agency data; change vs the same period of the previous year

BRENT PRICES

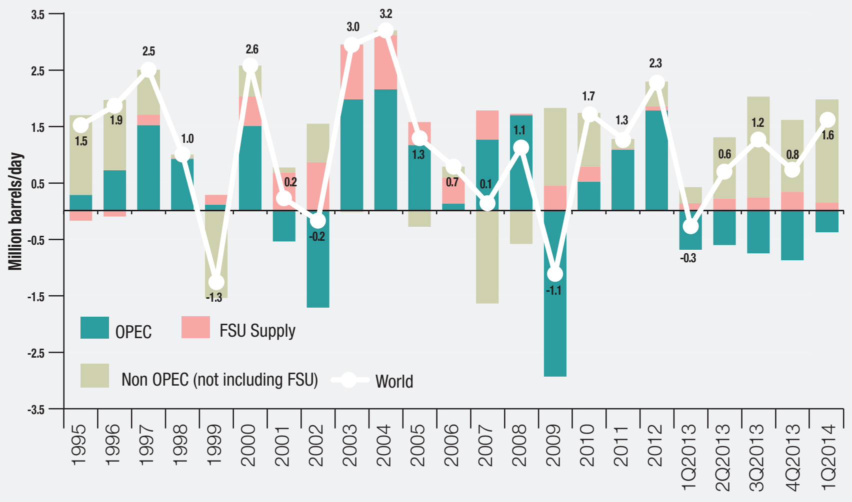


Source: IEA, spot price of Arabian Light (1970-1985); IEA, spot price of Brent (1986-1987); Platt's, spot price of Brent Dated (from 1988)

GLOBAL SUPPLY



VARIATION IN GLOBAL SUPPLY BY AREA



Source: Eni's processing of International Energy Agency data; change vs the same period of the previous year

Oil supply

At the start of 2014, global supply exceeded 92 Mb/d for the first time, marking one of the biggest increases in recent years (+1.6 Mb/d compared with the first quarter of 2013). The spurt in North American production continues: for more than two years the region has recorded growth levels of more than one Mb/d, driving all non-OPEC countries. Since the beginning of the year, U.S. oil (crude and natural-gas liquids (NGL)) has now stabilized above 11 Mb/d, having overtaken Russia and hot on the heels of Saudi Arabia, which it could overtake at the end of 2014. Other large producers have also recorded positive performances: development of oil sands continues in Canada (+0.2 Mb/d), with an increase in bitumen production coming from the Kearl and Christina Lake projects; in Brazil too, supply is showing positive signs after two years of decline, thanks to the development of pre-salt fields; lastly, additional production in eastern Siberia is driving Russia's output. Within the OPEC area, there has been a further slowdown in production: the geopolitical situation has entirely dominated the quarter, with the aggravation of the crisis in Libya and widespread fears of a possible coup d'état. Continued attacks on the pipelines gradually reduced the country's output, which was 0.5 Mb/d in January, which then fell to slightly above 0.2 Mb/d. On the Iranian front, negotiations between the country and the P5+1 continued, even if it did not seem that they were getting close to finding a solution, while Asian countries and Russia increased their purchases of oil bringing export levels above the limit set by the agreement at the end of 2013 (1 Mb/d). At the June meeting, confirming the previous production level of 30 Mb/d, OPEC reaffirmed its interest in keeping the market balanced. Geopolitical risk also makes the situation outside of OPEC countries difficult: production in South Sudan in the Dar Blend area, which is under the control of rebels, is critical. In Yemen, the Masila and Marib pipelines continue to operate in fits and starts. At the end of February, a new piece of the jigsaw puzzle was added to the current geopolitical crises: the civil war in Ukraine, though this does not affect the transit of Russian crude oil to Europe. Although the outcome is still uncertain, there have, however, definitely been significant impacts as the Iraqi crisis intensified in June: exports at risk stand at 2.65 Mb/d of oil, equal to the spare capacity of Saudi Arabia.

Oil

July 2014