North American energy

Oil and water

North America’s energy revolution will have a ripple effect around the Pacific

Nov 15th 2014 | From the print edition
TO FIND OUT how much energy security has mattered in the Pacific’s recent history, ask the Japanese. At the museum of the Yasukuni Shrine in Tokyo, which honours the country’s war dead (sometimes controversially), an exhibit suggests, with a jarring note of self-justification, that an American naval blockade against Japanese oil imports in 1941 triggered the Pacific war.

Seventy years later a tsunami that swooshed in from the Pacific and knocked out the Fukushima Daiichi nuclear power station led to the closure of Japan’s 54 nuclear reactors. Parts of the country, which is a greedy consumer of electricity, were left practically powerless. Huge tankers full of natural gas, heading for terminals dotted along Japan’s Pacific coastline, eventually got the country up and running again. In 2012 Japan consumed 37% of the world’s liquefied natural gas (LNG).
The past few years have seen some upheavals in the balance of energy security around the Pacific. America, which used to be the world's largest net oil importer, ceded that spot to China in 2013 (see chart 4). Thanks to shale oil and gas, this year it is set to become the world's biggest producer of oil and liquid natural gas. It is already the number one producer of dry natural gas.

That highlights the prospect of huge trans-Pacific complementarities. China is reducing the dominance of dirty coal in its energy mix, Japan and South Korea are denuclearising, and fast-developing countries like Indonesia are turning from LNG exporters to importers. Yet to date there is next to no trans-Pacific trade in oil, gas or coal in either direction; in 2011 the Singapore-based Pacific Economic Co-operation Council (PECC) said it added up to only 1.4% of global trade in those products.

According to statistics from BP, a global energy firm, North America gets most of its crude-oil imports from Canada or via its east coast from Latin America, the Middle East and west Africa. Asia receives the vast majority from the Middle East via the South China Sea. The Pacific is a big blank. But that may be about to change, with potentially big implications for the economic interdependence and geopolitics of the Pacific region.

Time to share the bonanza

The epicentre of the change is North America, whose huge gas discoveries are about to turn it into a global LNG power. In Canada Asian-owned companies plan to build the first export terminals on the coast of British Columbia in the next few years to ship LNG across the Pacific. In the United States the government has recently approved the construction of four terminals to liquefy gas and ship it west via the Panama Canal.

One of those, Dominion Energy’s Cove Point, near Washington, DC, built as an LNG import terminal in the 1970s, had been mothballed for much of the following three decades. Not long after it resumed receiving LNG imports in 2003, American natural-gas prices plummeted in response to the shale revolution, putting the terminal out of business again. So in 2011 Dominion switched to marketing Cove Point to foreign LNG customers as a potential export facility. On September 29th this year the Federal Regulatory Energy Commission finally approved construction of an export terminal. Those LNG exports will benefit from a $5.3 billion expansion of the Panama Canal. Due to be completed (after several delays) in 2016, this will make the canal big enough to accommodate nine-tenths of the world’s LNG fleet, potentially cutting at least 11 days off shipping times between the Gulf of Mexico and East Asia.
The implications of this new trade on both sides of the Pacific could be substantial. According to Jane Nakano, of the Centre for Strategic and International Studies (CSIS) in Washington, as of last year Japan had contracted to buy about a fifth of its LNG imports from America once it gets the necessary permissions.

Currently dry gas in America costs $4-5 per million British thermal units (MBTUs). Even allowing for another $6 or so to liquefy the gas and transport it to Asia (and far less from Canada’s west coast), the price would still be a lot lower than the $15-18 per MBTU that LNG currently fetches in Japan. Cheaper energy would make Japan’s economy more competitive, and America would see a much-needed improvement in its trade balance.

For American exporters, that scenario involves risks. Australia, one of the world’s two biggest LNG exporters, is ramping up its output over the next five years, much of it destined for Asia. China, another big potential buyer, appears to be avoiding American LNG. This year it signed a $400 billion deal with Russia to import natural gas from there for the next three decades.

But the energy markets of China and North America are warily intertwining in other ways, mainly through Chinese investment in oil. North America has received a flood of investment from Chinese oil companies since the global financial crisis. In 2012 CNOOC, one of China’s state-owned energy behemoths, bought Canada’s Nexen for $15 billion, seven years after its bid for America’s Unocal was scuppered by opposition in Washington. The welcome is not always open-armed. After the Canadian deal the prime minister, Stephen Harper, put a financial limit on further acquisitions: “Canadians have not spent years reducing the ownership of sectors of the economy by our own governments only to see them bought and controlled by foreign governments instead,” he said.

But Mexico, which in 2013 changed its constitution to allow foreign investment in its oil industry for the first time in 75 years, would welcome China with open arms if it wanted to invest in its energy sector, according to Ildefonso Guajardo, its economy minister. Tellingly, in the past two years Mexico’s president, Enrique Peña Nieto, has had four meetings with his Chinese counterpart, Xi Jinping—the same number as with President Obama.

The benefits of this new North American energy glut go far beyond the oil industry. For a start, it is making North American manufacturing more competitive. The combination of cheaper energy and rising Chinese wages could make Mexico a more attractive factory floor. But it is also sending two powerful geopolitical signals: one to America’s close allies, such as Japan and South Korea, that the friendship can now also help underpin their energy security; the other, to the wider Asian region, that North America has bounced back from the global financial crisis. In time, such symbols of economic revival could resonate strongly on the
other side of the Pacific. Eduardo Pedrosa, the Singapore-based secretary-general of PECC, calls it a tectonic shift in American competitiveness. “I don’t think anyone over here realises how massive this shale revolution is for the US economy.”

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