

Chapter 4

Policy Recommendation

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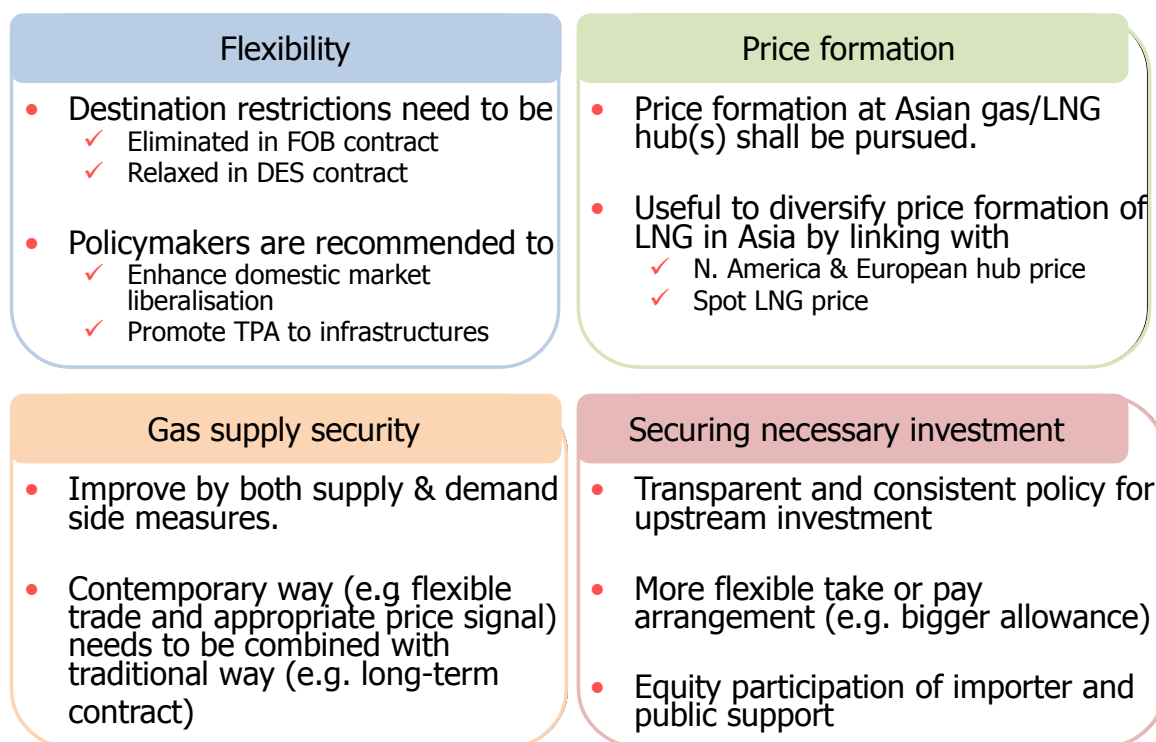
ERIA (2016), 'Policy Recommendation', in Koyama K., I. Kutani and Y. Li (eds.), *Joint Study for Liquefied Natural Gas Market*. ERIA Research Project Report 2015-11, Jakarta: ERIA, pp.14-16.

CHAPTER 4

Policy Recommendation

The liquefied natural gas (LNG) market is in transition in terms of geographical and quantitative expansion, diversification of price formations, and lower oil and gas prices. In order to balance benefits between importers and exporters and to find workable solutions for sustainable LNG market development in varied energy situations in each importing and exporting countries, the LNG market players and policymakers are encouraged to enhance their efforts to create more flexible, transparent, and sustainable LNG market in Asia. Although the private sector is mainly responsible for commercial deals, the public sector is encouraged to support in improving the business environment to develop a better-functioning LNG market especially in terms of flexibility, price formation, and gas supply security; and in securing necessary investments (Figure 4.1).

Figure 4.1. Overview of Policy Recommendation



DES = delivered ex-ship, FOB = free on board, LNG = liquefied natural gas, TPA = third-party access.
Source: Study Team.

4.1 Flexibility

Enhancing flexibility is the key to a better-functioning LNG market in Asia. Not only international LNG but also domestic gas markets should be more flexible.

Contractual flexibility should be enhanced by eliminating destination restrictions in FOB contracts and relaxing them in DES contracts.

Policymakers are recommended to enhance domestic gas market liquidity through liberalising domestic gas market and prices, and developing adequate and accessible gas infrastructure capacities by promoting such measures as third-party access to gas infrastructures where applicable.

4.2 Price formation

Oil indexation has rapidly lost its relevance in recent years because oil is increasingly less competing than gas and is unable to track LNG market fundamentals. Gas-on-gas competition (market) pricing is fundamentally desirable so that the market fundamentals of LNG can be directly reflected on price.

Price formation at Asian gas or LNG hub(s), such as wholesale domestic gas market in Asian importing countries, as well as in spot LNG market, should be pursued. Singapore intends to establish a hub, and some other countries are exploring the possibility of this kind, including Japan. Further investigations and actions toward establishing Asian gas or LNG hub(s) are suggested.

It will be useful to diversify price formation of LNG in Asia by linking with North American and European hub pricings and spot LNG pricing, while tackling the following: (i) modifying Japan customs-cleared crude pricing to better reflect market conditions; and (ii) making continued efforts to develop Asian gas or LNG hub(s).

4.3 Gas supply security and the role of functioning market

Gas supply security attracts greater interest not only in Europe, where the conflict in Ukraine overshadows, but also in many Asian countries since their gas demand and import dependency soar.

Gas supply security should be improved by both supply and demand side measures, such as diversification of supply sources, including pipeline gas; development of emergency response scheme; improvement of energy efficiency; removal of price subsidies; and enhancement of demand flexibility.

Contemporary approach, such as flexible trade, for instance, between the European and Asian markets, and appropriate price signal of LNG are suggested to be pursued since these are important elements that can ensure, particularly in short term, gas supply security in a global LNG market. Traditionally, long-term contract has played this role. However, when

considering dramatically changing circumstances in each regional market, where steady progress takes place toward market liberalisation, it is obvious that long-term contact alone cannot fulfil the requirement of supply security.

Further, destination restrictions in contract need to be eliminated or relaxed to enhance flexible trade of LNG.

4.4 Securing necessary investments

It is critical to secure adequate and timely investments to realise additional LNG supply potential to meet the growing LNG demand in Asia, particularly in a current lower gas price circumstances.

The governments of LNG exporters are expected to maintain transparent and consistent policy to encourage upstream developments, while respecting social and environmental considerations and restrictions. The governments of LNG importers are expected, on the other hand, to promote adequate and accessible infrastructure developments.

Take-or-pay condition has been playing an important role to commercialise new LNG projects. However, in response to substantially changing market, it is suggested to pursue expanding allowances of downward quantity tolerance (DQT) and upward quantity tolerance (UQT) as much as possible.

Equity participation of importers and public support are suggested to be hired when private finance is not sufficiently available due to price uncertainty in the future.