

# TLG on



THE LANTAU GROUP  
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## Engaging with Uncertain Policy Environments

Lester, L (2016) Engaging with uncertain policy environments, *TLG on* 3(3), The Lantau Group (HK) Limited

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Asia's phenomenal economic growth over the last two decades rests firmly on the shoulders of fossil fuels, in particular coal, a reliance that is projected to continue given the relative reliability and low cost of coal-fired power. Yet this reliance on coal must be set against a changing and uncertain landscape: coal prices have risen sharply in 2016, oil and gas prices remain at their lowest for ten years, solar and wind options have gained in competitiveness and, with global climate change agreements such as Paris 2015, governments have gained confidence in announcing stronger environmental targets and objectives.

With these developments in climate change governance, traditional models within Asia have come under greater scrutiny and threat. Despite the recent COP22 meeting in Marrakech, the possible resurgence of US climate change skepticism leaves the sector facing a period of uncertainty. Does Asia's growing interest in greener energy mark the beginning of a fundamental shift for the region, or will it prove a flash in the pan? While greater scrutiny need not necessarily mean greater clarity for Asia's energy sector stakeholders, improved understanding, with clear insights based on rigorous quantitative (where possible) and qualitative (where necessary) analysis, remains key to better policy.

## Key Points

- Asia's involvement with global climate change governance has undergone a profound shift with the implementation of the Paris Agreement and the commitment from Asian countries to develop and enforce individual national climate change initiatives. Asia's energy stakeholders may now find themselves exposed to new policy risks.
- Climate change policy is often inconsistent and marked by constructive ambiguity: the actual meaning of clauses may only emerge as a product of time and precedence. Businesses need to understand, and accept, the messy nature of political economics, and adopt strategies that retain enough flexibility to deal with these uncertainties.
- Lack of data makes proper policy formulation and the measurement of cost-effectiveness difficult. Improved data transparency is slowly becoming a higher political priority. Proactive Asian power stakeholders will not only be able to engage more fully in policy debates, but will also realise further strategic benefits from the development of a data-rich portfolio-view of exposures across technologies, geographies and fuels.

# A Changing Climate Governance Framework For Asia?

The November 2015 Paris UN Climate Change Conference marked a watershed in international climate change negotiations as a long-term framework (which entered into force on 4 November 2016) was developed with a view to constrain climate change to under two degrees Celsius.

It also marked a watershed for Asia's involvement with global climate change governance. Gone is the Kyoto-era country classification system, in which Asia was largely spared any formal requirement to cut emissions. Under the Paris Agreement, the long held principle of common but differentiated responsibilities is retained, but this time Asian countries are active participants. At the time of writing, twenty-two countries within TLG's geographical remit had already submitted their Intended Nationally Determined Contributions (INDCs). In fact, China had gone further, earlier, with its 2014 announcement that carbon dioxide emissions would peak by 2030.

In this context, climate change policy has emerged as a disruptive force to the traditional Asian power sector even as the near term options for meeting electricity demand growth remain largely unchanged. With greater awareness and commitment, the tenor of environmental and energy policy is shifting. Yet this shift is anything but a one-off, and regulation is anything but static. For power-sector decision makers used to the straightforwardness of a coal dominated industry, change and uncertainty are becoming the new normal.

As became clear in discussions at a recent Konrad Adenauer Stiftung/Tongji University hosted workshop<sup>1</sup> in Hong Kong, this uncertainty is worsened by two main issues:

- Political and policy inconsistency; and
- Increasingly ambitious and onerous disclosure requirements.

In each case, the implications for risk and opportunity in the Asian electricity and gas sectors are complicated and in flux. Energy forecasts largely retain a consensus view that fossil fuels, and especially coal, will continue to dominate the global and Asian energy mix out to 2030 and beyond. During the same timeframe, a massive expansion in renewables is also expected. In both cases there is ample room for growth and investment, and yet in both too, the route to successful, high-value commerciality is no longer as straightforward as it once was.

## (De-)Constructive Ambiguity

So inherent is the vagueness of climate policy that it has been described quaintly by some as constructive ambiguity. So nuanced do policy phrases become through the long hours of United Nations led negotiations that their actual meaning may only emerge later over time. As social and political preferences and priorities shift, so do the interpreted meanings: consensus definitions may be more the result of post-negotiation power struggles than scientific, technological and economic rationale.

If this sounds dispiriting, perhaps it is, but it should not surprise. Political organisations, at whatever level, secure their external support from disparate stakeholders with competing priorities. This only worsens as one moves from the town hall to the UN

The tenor of energy policy is shifting, disrupting traditional models.

The route to high-value commerciality has become more complex.

Climate change policy suffers from constructive ambiguity, often arising from the competing demands placed on policymakers.

<sup>1</sup> On 27-28 October 2016, the Konrad Adenauer Stiftung and Tongji University of China held a joint workshop on "Emerging Issues in Global Climate Governance after Paris" at the Kowloon East Crowne Plaza, Hong Kong. The Konrad Adenauer Foundation offers political education nationally and internationally to forward peace, freedom and justice (<http://www.kas.de/recap/en/about/>). This article reflects TLG's commentary and analysis on the themes raised during the workshop.

Rules of thumb may no longer be adequate: complexity is here to stay and new strategies are needed to retain flexibility.

Demand for better data is expected to grow from both policy makers and industry.

general assembly. Policymakers tend to approach these inconsistent demands by addressing some through speeches, some through published decisions, and some through actions. The hypocrisy of politicians has long been decried, but there are solid reasons for it: the different stakeholders demand conflicting responses. As a result, policy making might more fairly be described as the process of dealing with problems, rather than necessarily solving them.

If this inconsistency leaves business struggling to decipher what the future investment environment will be, the gulf between, on the one hand, scientific advice, technical know-how and economic viability, and, on the other, the assumptions of policymakers, only worsens things. But the fact is that we need to take politics as it is, and leave behind simple rules of thumb and assumptions of political constancy and consistency. We need to realise, and internalise, the complexity of the real, political, world.

In the short term at least, energy policy and regulation is unlikely to get simpler, nor any clearer. What is likely more certain, is that the challenges Asia's energy stakeholders will face tomorrow will be qualitatively different from those faced yesterday. New skills and strategies will be needed, as will the flexibility to recognise that even the best decisions cannot always guarantee good outcomes. More frustratingly for business, the reliability and predictive power of traditional analytical techniques applied to simplified scenarios may become increasingly circumscribed.

Some policies create conflict amongst possible choices. For example, policies that support both solar and natural gas will find themselves in conflict in Asia where gas-based mid-merit and peaking capacity competes with solar generation output during the daytime. In contrast, some policies create opportunities for those who have already established positions in traditional fossil fuels by making it more difficult to develop competing options. Asia's growing economies will continue to need energy, but parsing these risks and formulating strategic directions is becoming more difficult.

## To Measure Things You Have to... Well, Measure Them

The lack of information transparency and the dearth of good data do not only afflict businesses as they make investment decisions. They can also stymie policymakers as they seek to develop frameworks that can deliver real outcomes.

Put simply, when organisations such as China's National Development and Reform Commission (NDRC) set about drawing up their post-Paris Agreement INDCs, they need to know how much carbon dioxide the country is already emitting. The result has been a growing demand for better data. To continue with the example of China, there has been a move towards the centralisation of power to bring greater consistency in policy implementation and enforcement between provinces, but also to improve the consistency of data collection.

Perhaps more importantly, regulations in China have begun to identify accountable departments, and cadre promotion has become more tightly pegged to performance against environmental criteria (as it so successfully was before against economic ones).

As governments task their ministries to collect more data, so companies, energy providers among them, can expect more stringent environmental reporting regulations. The questions policymakers are grappling with are not getting any easier. For example, some researchers are challenging natural gas' green credentials based on the unknown levels of methane leaks during production; clear and transparent tracking of methane escapes would provide the industry with the necessary defence. Improved understanding of the consequences of enhanced energy efficiency vis-à-vis the rebound effect (in which energy saved in one area is used by consumers in new areas) could lead to

Stakeholders can benefit from pro-actively improving the collection and use of data.

TLG is experienced in helping Asia's energy stakeholders grapple with the consequences of changing policy.

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further emission-related regulations. But for policymakers to act properly, and for business to respond constructively, the data needs to be available.

This trend towards greater disclosure is not new, but it is an area in which much of Asia has traditionally been perceived as relatively weak. Investor led reporting standards have long been more stringent in the West, with regulatory filings for the United States' Securities Exchange Commission being seen by some as especially onerous. Yet in the light of growing social awareness of sustainability, more informal investor, business and not-for-profit led organisations are also detailing new reporting standards. The Global Reporting Initiative (GRI), the Dow Jones Sustainability Index and the FTSE4Good series are just three such examples. Their penetration in Asia remains low, revealing both the information gap facing Asian energy stakeholders, and the potential financial opportunities to be gained.

But what data are really needed and for what purposes? It seems unlikely Asian countries or businesses will quickly close the data gap, but policy analysis can still benefit from improved understanding of cost-effectiveness even with relatively sparse data. Comparing the effectiveness of different approaches to decarbonisation can reveal better ways to reduce carbon and other emissions without squandering Asia's financial capital needed for priority infrastructure and socioeconomic development.

## Your Partner in TLG

The Lantau Group has been involved in a wide range of engagements that reflect this growing trend to incorporate greater climate policy risk sensitivity into commercial decisions, portfolio evaluations, regional strategy development, and regulatory policy. We've presented at the IEA on the socioeconomic benefits of advanced coal technologies used to displace older higher emitting coal units; advised numerous stakeholders on the economics and commercial challenges of LNG infrastructure development; advised on the opportunities and risks associated with gas versus coal and, even more interestingly, solar versus gas. And we've been involved in thousands of megawatts of wind, solar, and hydro projects across Asia, including China.

In most countries we work with clients on issues as wide ranging as the pros and cons of fuel mix targets, renewable portfolio standards, carbon taxes, and net metering and feed-in tariffs. And we have worked alongside renewable energy investors in places such as the Philippines, to bring them greater clarity when developing renewable energy options in a merchant market without feed-in tariff support.

The Lantau Group remains committed to bringing its brand of rigour and excellence to tracking policy and regulatory developments so that we can deliver for our clients. As these issues grow in prominence throughout Asia, and the world, TLG will be there.

## About the Author

Leo specialises in Asia's political energy economy, and brings a decade of international energy experience, having worked in the UK, India, Thailand and Saudi Arabia. Initially in upstream business analysis and strategic planning at an international oil and gas company, Leo most recently led the King Abdullah Petroleum Studies and Research Centre's work in North East Asia.

Leo holds degrees from the Universities of Oxford (MA) and Reading (PhD), and is a Global Research Fellow at the Institute of Asia and Pacific Studies. He has numerous publications and was editor of *Energy Relations and Policymaking in Asia*, published by Palgrave Macmillan in 2016. He is a CFA charter holder and a certified Financial Risk Manager.