

THE CHALLENGES OF A CHANGING INTERNATIONAL ENERGY MARKET

Luncheon Speech by Helga STEEG
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Monsieur Mernier

Many thanks for the invitation.

Ladies and Gentlemen,

Before this audience I need not enumerate the different elements which have brought about the worldwide fundamental changes in the international energy markets. These changes were never smooth or without confrontation. Different interests between energy producers, consumers and industry have characterised energy trade in the past, and that in my opinion will not change in the future.

However, globalisation and the change in the respective shares of energy demand from the OECD countries, on the one hand, and from the growing number of emerging economies, on the other, is leading to new patterns of demand for available energy. In other words, if energy supply is not sufficient to meet the growing demand, the distribution of available supply will be at stake and will result in risks of political or economic confrontation - in German this is called “Verteilungskämpfe” (distribution crises).

Energy is, as compared to other commodities, of a highly strategic nature for individual countries and for the global economy, therefore these confrontations can be extremely dangerous for the global economy. While the potential risk is basically not so new, the global situation certainly is. In addition, a new political concern is growing: awareness of the potential use of energy exports as leverage for political goals. I hasten to add that these fears may very well be exaggerated, but it seems worthwhile to mention them in order to exclude some premature reactions right from the beginning. Based on these fears, international protectionism seems to gather ground.

With the change of the international energy scene, the Conference organisers rightly raise the question whether the new interplay between different forces active in the international energy sector today requires an international framework to address a new phase of interdependence. The analytical approach must be a realistic one and pragmatism should take the lead from the beginning of the discussion. This is a very wide field and the answer must include various aspects. It would be naïve to strive for the elimination of the existing differences of policies and practices of different countries, notably between producers and consumers. Let me just take the opportunity to welcome the participation of the Secretary General of OPEC in the Conference today. Back in 1984, when I was appointed Executive Director of IEA I had to discuss in secret issues of common concern with the then representatives of OPEC. So there is much improvement now. For the future, we should try to identify areas where common interests could be found.

Before going into more detail, let me deal with one possible institutional approach that I heard discussed recently at a conference in Berlin, namely some UN-type of global energy governance. My answer to this idea is that experience shows that those international organisations which focus on sector-specific cooperation according to their mandates have until now been the only successful ones. Let me mention the WTO, IAEA, IEA, ECT, OPEC and the UN Climate Change Secretariat. The IEF is not an organisation but a voluntary getting together of producer and consumer countries, notwithstanding that its meetings are of value in terms of more transparency and better analysis. The same in my mind also holds true for the G7 and G8 summits; all the more so after the G8 summit at Heiligendamm where a number of emerging new players were invited for the first time. Let me add that having met your personal counterparts is an important asset to enter into a dialogue in times of crisis.

What then are the areas which might lend themselves to further progress? Let me mention:

- a. Energy trade especially for processed goods as well as uninterrupted transit through third countries.
- b. Timely investments both in the downstream and upstream areas.
- c. Competition and how to deal with private or state-owned monopolies.
- d. Development, application and transfer of new cost-effective energy technologies.
- e. Sustainability and lowering greenhouse gas emissions stemming from energy.

I shall not comment on all these issues. Also I have not mentioned price formation where the underlying factors - supply and demand – are the determinants. Speculation in the markets is in the first instance fed by assumptions of geopolitical crises and also

risk assessments of future market developments. Surely speculation has several faces, but I do not believe there is any methodology to influence prices directly. Exchange rate formation and turbulences on the money markets are relevant examples in this respect.

I shall now focus on two issues of my above mentioned list: the first is an issue from the trade area - uninterrupted transit through third countries – and the second concerns international energy investments.

Let me start with transit. WTO is the organisation to deal with trade, including energy trade, all the more so since most of the countries important for world energy trade have become members. However there is a need for more clarity in the transit field. Despite Article 5 of GATT (now embedded in the WTO) and Article 7 of the ECT, the problem of transit interruptions still exists. In view of the lengthy negotiations under the auspices of the ECT, I cannot refrain from bemoaning the fact that three of the draft Transit Protocol articles are still controversial. Furthermore, this Protocol is interlinked with the ratification of the ECT by the Russian Federation.

Here is a typical example where two important partners, and I mention both Russia and the EU, likewise have not yet made all efforts to bridge their differences. I express hope that a solution will be found. The Energy Charter Secretariat has already presented several proposals for compromise. It is important that the finalisation of the Protocol will be taken up at high political level. Once this protocol will be accepted it might very well be used by other countries outside the ECT as a model and thus contribute to security of supply. Also the Russian ratification of the ECT seems vital to me to set a good example for fruitful cooperation in the Eurasian area.

Huge and timely investments both in the upstream and downstream area of hydrocarbon energy are vital to avoid distribution crises. Otherwise the world might run open-eyed into big supply deficits with the consequence of market volatility and climbing prices. The IEA is constantly warning against such inaction of potential investors. Let me explain which possibilities for progress and international cooperation both by governments and industry I see. Admittedly we find different concepts and practices for national and international investment regimes. They stem from a number of historical and structural differences.

Considerable controversies and even collisions between states, governments and industries are painted on the foreign investment tableau. And a number of new developments give reason for concern for today and the future. What are the reasons? Firstly, we notice new flows of activity in foreign industrial investments and capital deposits by emerging economies and energy resource owning non-OECD countries into OECD countries. Secondly, fear is being expressed that national security interests might

be at stake in case of takeovers by foreign investors being governments or state-run funds backed by huge amounts of accumulated foreign monetary reserves: Above all, the fear is that these investments could be used to exercise political leverage.

A number of EU and OECD countries – including my own - are considering policies and practices to shelter their countries from these foreign influences in the investment area. As an example, energy is mentioned as a sector to protect. I call this a rebirth of bad national protectionism. Not only have Russia and China expressed their rejection of such policies but these shelters may very well act as a boomerang for investors in energy resource owning countries. The situation resembles in my view flying nervously into the woods instead of addressing some new developments from a rational point of view. I shall not deal with all the different cases of bad practices or new concepts both by EU members, including my own country, as well as by the USA, nor with countries like China and Russia and India which definitely do not have anything comparable to the open investments regimes of OECD countries.

Under the aspects of possible future progress one should try to identify areas where common understanding might be reached more quickly. Distinction must be made between industrial investments and capital portfolio deposits by hedge funds or national monetary authorities. The latter developments are under discussion in the OECD and the IMF, where they belong.

As far as industrial investments are concerned the issue of how to ensure some comparability of national investment regimes should be approached. Firstly, there is a difference between exploitation of resources, on the one hand, and processing and manufacturing on the other. For reasons of national sovereignty, resource owners often restrict the access to their resources to national owners. Under the aspect of a pragmatic approach this area might not be the first to open up for foreign investors provided the necessary investments are undertaken. Nevertheless the question remains if these investments do take place. This question must be looked into carefully.

The whole area of processing, manufacturing and local distribution might lend itself more easily to common understandings. Many resource-owning countries outside the EU and OECD area are looking for interesting investment opportunities in OECD countries as well as for sharing new technologies. Here in my mind there could be some ground for progress through a two-way concept. Let me give you an example: if Gazprom is interested in some participation in German distribution chains, why not call for opening up more participation in Russia in the investment area. It would ease the situation if we could assess investments on a cooperative basis, and I see ground for

making progress based on the comments made this morning by Minister Denisov regarding shared investments.

What I suggest in more general terms are two ways. First companies should be faced with fewer restrictions on a project-specific basis. Here governments should take a more open position. Furthermore, governments of producing and consuming countries should look for a new international investment regime which contains long-term, stable investment protection in the pre-investment as well as in the investment phase, in line with the rules of bilateral investment protection treaties and the stipulations of the ECT. There is a big imbalance of policies between producing and consuming countries. I am aware that the inclusion of the pre-investment area, that is, the admission of new investments, is the most difficult one.

But in dealing with the energy sector, it should be possible to reach some common understanding between governments at least for the processing or distribution phase. Also very important are rules on more transparency both for the investor as well as for the guest country. Dispute settlement needs to be based on clear access rules. Eventually the G8 or a somewhat larger group might set up a group, for example comprising of the Energy Charter, the IEA and perhaps the IEF to define such investment regimes. They should start by defining some essential minimum requirements for investment regimes. Lastly, governments and the energy industry must be further convinced that competition leads to more rather than less investment opportunities.

In conclusion: the objectives of energy security, economic growth and sustainability seem to be shared by everybody but large areas of specific work lie still before us.