Mr Chairman, distinguished participants,

It is an honour for me to address this prestigious forum, and I would like to use the time available by providing a perspective from the Energy Charter on four main features of the current Eurasian energy scene:

- Firstly, the issue of energy pricing, and in particular the pricing of Russian energy exports to its immediate neighbours;
- Secondly, the challenge of securing adequate investment all along the energy chain;
- Thirdly, the emergence of new export routes, in particular for natural gas, and the implications for Eurasia of growing energy demand in East and South Asia, and;
- Last, but far from least, some words on environmental aspects and the importance of energy efficiency.

I will conclude with some observations regarding the relationship between the EU and its eastern neighbours, including Russia, and also with the countries of the Caspian region, and on the role of the Energy Charter.

Mr Chairman, a major development in Eurasian energy over the last two years has been the move towards new commercial pricing for Russian exports to its immediate neighbours. This has stimulated a vigorous debate about whether this is a political exercise by Russia, and whether energy is being used as a political weapon. I would like to comment on this debate.

The first point to underline is that this process undoubtedly has a political component, in that it started with a political decision to move to a new commercial pricing formula. This new mechanism links the price of Russian exports to Ukraine, Belarus and other countries to the price paid in the main European export markets, minus the costs of transportation. As we have seen, this implies a dramatic increase in energy prices for these countries, with significant economic, social and political implications.

However, the net effect of this process – if it is followed to its logical conclusion – will actually be to remove the political aspect from energy pricing for Russian exports, since export prices in all third countries will be linked to a market reference point.

The perspective of the Energy Charter on this is straightforward. One of the core principles of the Charter is ‘market-oriented price formation’, reflecting the belief that the market is the most efficient mechanism for allocating a scarce resource. In this
context, the changes in pricing policy announced and implemented by Gazprom represent a positive step away from ‘friendship pricing’ towards market pricing.

The Energy Charter does not interfere in negotiations between our member states on energy supply or pricing. We do, however, seek to inform the debate: in response to demand from our member states, a major report from the Charter on international pricing mechanisms for oil and gas will be released next month.

In my view, the move to market-based pricing is ultimately in the interest of Russia’s partners. Paying a market rate for energy is a fundamental component of secure energy supply, and a pre-condition for diversification of supply – if you are not able to pay a market rate, you are in no position to negotiate with alternative suppliers. Market prices for energy are also an indispensable foundation for the ambitions of countries like Ukraine to develop closer ties with the rest of Europe.

At the same time, all sides should be interested in an orderly transition, and an open question is the speed at which Russia’s neighbours are required to make this adjustment. This is a matter for negotiation, and it will be helpful in this context to have strong, open dialogue, and – as much as possible – greater transparency on the commercial arrangements.

As we have seen in the cases of Ukraine last year and Belarus this year, where there are strong disagreements over the conditions for energy supply, it is the transit of energy to European markets that takes the strain. This has produced temporary disruptions to supply in early 2006 for gas through Ukraine and in early 2007 for oil through Belarus, and also stimulated a broad debate on European security of supply.

However, I see these temporary disruptions as a product of this adjustment to higher energy prices in Russia’s neighbours, and not as indications of any larger systemic crisis. While there is still a need for greater transparency and early information in the handling of such disputes, I do not consider that they give grounds to call into question Russia’s reliability as a supplier to European markets.

The issue regarding future Russian supply is rather to ensure that the necessary investments are made in time to meet future demand, and this is the issue to which I would like to turn, with a focus on the markets for natural gas.

It is clear that enormous investments are going to be needed to develop new fields, in order to compensate for depletion of the existing supergiants in western Siberia. Moreover, these new investments present major geological and environmental challenges – for example the complex offshore arctic development of the Shtokman field.

It is for Russia, as for any sovereign state, to decide on the depletion policy for its natural resources. This right is explicitly confirmed by the Energy Charter Treaty; there is no obligation in the Treaty – contrary to what is often reported – to open up access to resources for foreign investors.

However, the challenge for Russia remains: to ensure that these complex investments are made in time in order to meet future supply obligations. I believe
that foreign investment, international capital and expertise, as well as the contribution of independent Russian producers, are an important part of the solution.

We recognise that the risks facing such investments are significant, and that mechanisms are needed to mitigate these risks. On this point, the Energy Charter Treaty is best available instrument: once an investment is made in the energy sector, the Treaty provides binding protection against key non-commercial risks, such as discriminatory treatment, direct or indirect expropriation and the breach of individual investment contracts. This additional degree of legal security is backed up by mechanisms for dispute settlement, and is particularly important for highly strategic and capital-intensive projects, where risks have to be assessed over a long time horizon. I take this opportunity to remind you all, while talking on this topic, that Russia has signed the Energy Charter Treaty, and has accepted its provisional application.

At the same time, we also need to recognise that there has been a shift in the terms of the relationship in Eurasia between the OECD countries – which are primarily importers of energy – and Russia and other Eurasian energy producers. It is no longer the case that this relationship is about western investment capital in exchange for upstream investment opportunities.

The situation today is that this relationship can involve mutual exchanges of investment all along the energy chain – and that companies like Gazprom and the Russian oil majors will be investing in downstream markets.

A key challenge is to develop a political consensus about the terms for these investments. In turn, the Energy Charter Treaty can well accommodate this change in emphasis: political risk is not unique to upstream markets, and the Treaty’s instruments for investment protection are neutral and apply all along the energy value chain.

Mr Chairman, I would now like to say a few words about transportation and infrastructure. The energy business has always been an international one, but, with trade in energy growing faster than consumption, the relative importance of international trade in energy has never been as great.

The geology and geography of Eurasia means that large volumes of oil and gas are transported by pipeline, often across multiple land borders. A vital issue for Eurasian energy security is therefore a multilateral mechanism to ensure reliable cross-border flows in general, and attention to the issue of energy transit in particular.

The Energy Charter is best placed to tackle this issue because of its broad geographical coverage, and because the Treaty establishes common obligations to which all member countries subscribe. Parties to the Treaty are under an obligation to facilitate energy transit, and not to interrupt or reduce existing transit flows. As production areas become ever more distant from the main consumer markets, this aspect of the Charter’s role will only increase in strategic value.

The combination of investment security and reliable cross-border flows is essential if producer countries are to diversify export routes, and consumer countries are to
diversify supply. For example, the Energy Charter Treaty has played an essential role in providing legal security for the Baku-Tbilisi-Ceyhan and South Caucasus Gas Pipeline projects.

Looking at Eurasia as a whole, a striking feature is of course rapid demand growth in East Asia, primarily in China, and in South Asian countries such as India and Pakistan. We see new cross-border projects being implemented, such as the new oil pipeline between Kazakhstan and China, and many more projects on the table.

The countries of southern and eastern Asia are interested in international instruments that can promote regional energy trade, and this is why we see an increasing interest in the Energy Charter: Afghanistan signed the Energy Charter political declaration in August 2006, and in November Pakistan’s request to accede to the Treaty itself was unanimously approved by the Charter’s existing member countries. China is also an observer state.

Over time, increasing demand from Eastern and Southern Asia will pull Eurasian resources eastwards. However, I would not like to exaggerate the implications of this trend. Pipeline supply to Asian markets is likely to come largely from new reserves in eastern Siberia, which still need to be developed. We also need to remember that the interdependence of the EU, Russia and other CIS producers and consumers has deep roots:

- pipelines are fixed, and the Eurasian pipeline network runs east to west, and;
- the wider European market is still clearly the largest, most attractive and reliable market in Eurasia.

A final feature of current Eurasian energy, indeed of global energy, that I would like to highlight is the increased awareness of the need for efficient energy use.

In Eastern Europe and the Caspian region, this consideration is rising fast up the political agenda because of increasing energy prices. In the EU and Japan, it is based on a combination of price and environmental factors.

We see this change reflected also in the work of the Charter. The Charter’s contribution is based on a Protocol on Energy Efficiency and Related Environmental Aspects, and aimed at incorporating energy efficiency objectives and strategies into national policies. There is a need to transfer experience from OECD Europe to countries which are just starting to develop a coherent energy efficiency strategy, and the Charter provides a unique forum for knowledge sharing and dissemination of best practice.

I see the importance of the Charter’s role in this area increasing; the Protocol is the only multilateral instrument that focuses specifically on energy efficiency and that brings such a quantity and variety of Eurasian countries into a cooperative relationship.

Ladies and Gentlemen, it is no secret that there are significant challenges that need to be addressed in order to improve Eurasian energy security. The countries of Eurasia that together make up the constituency of the Energy Charter, have no
option but to work together to resolve them. We are mutually reliant and interdependent, and this will not change.

Last year, the leaders of the G8 came together in St Petersburg and agreed on the common principles that can enhance international energy security. In particular, they emphasised the importance of the transparent and predictable operation of energy markets, of an improved investment climate, of enhancing energy efficiency and energy saving, and of addressing climate change and sustainable development. These objectives are also the foundation for the Charter process, and so it was entirely appropriate that the G8 endorsed the principles of the Energy Charter and the efforts of participating countries to improve international energy cooperation.

The task now is to ensure that these principles are observed and implemented in practice, and this is where the Energy Charter Treaty makes a unique contribution. It is the only binding set of ‘rules of the game’ for the energy sector, and it also provides a balanced framework for countries in Eurasia to address key policy challenges. Irrespective of the continuing debate over ratification of the Treaty, Russia is a full participant in this work alongside 50 other countries across Europe and Asia. As Secretary General, my priority will be to ensure that the Charter continues to make tangible and visible contribution to energy security.

Thank you for your attention.