



Paris, 3 March 2006

**BIAC Letter to G-8 Energy Ministers**

Dear Minister,

The Business and Industry Advisory Committee to the OECD (BIAC) believes that ensuring a predictable supply of energy is one of the top policy priorities for business and governments in the major global economies. Secure, predictable, accessible and affordable energy is not only crucial for commercial activity, but it is also indispensable to economic growth, social development and improved quality of life. We are therefore pleased to see that energy security is so prominent on the G8 agenda.

Energy security is a broad concept, which significantly depends on the diversification of energy sources, increased investment and technological innovation. Mobilising the considerable investment required to ensure energy access and security will be a challenge for many countries for the coming decades and underlines the importance of a competitive energy sector. Good governance, strong institutions and integrated policies will support this investment and innovation. We therefore call upon governments to foster competitive and open markets and to commit themselves to consistent and enabling policy frameworks taking into account long-term investment cycles.

I am pleased to send you attached the statement BIAC submitted to the OECD Council Meeting at Ministerial Level at its meeting in May 2005, which summarizes our key messages for addressing investment challenges in the energy sector. We encourage Ministers to take OECD business' recommendations into account at their upcoming meetings, and we look forward to further discussion with you about how business and governments can work together to address energy challenges in the context of economic prosperity and sustainable development.

Best regards,

Thomas R. Vant  
Secretary General

Encl.: BIAC Statement to the OECD Council Meeting at Ministerial Level



*The Voice of OECD Business*

# **BIAC Statement to the OECD Council Meeting at Ministerial Level**

Paris, 3 May 2005

## **Part I: Investment Challenges in the Energy Sector**

# **BIAC STATEMENT TO THE OECD COUNCIL MEETING AT MINISTERIAL LEVEL**

3 May 2005

## **Part I: Investment Challenges in the Energy Sector**

### **EXECUTIVE SUMMARY**

Energy is an essential motor of growth and development for an ever increasing world population. Social and economic development can be attained only if a secure, reliable and affordable supply of energy is ensured. Achieving development goals in the poorest countries will require greater access to energy and improved energy services as a means to provide education, health, clean water and other societal needs.

In its 2003 World Energy Investment Outlook, the International Energy Agency (IEA) estimated that the total investment requirement for energy supply infrastructure worldwide over the period of 2001-2030 is \$16 trillion. Mobilising the required investment will be a challenge for the coming decades and underlines the importance of a competitive energy sector that can attract the much-needed investment. Financing energy investment cannot be taken for granted, and the key question will be whether conditions in the energy sector are right to attract the necessary investment with adequate incentives for investors.

#### ***Taking into account long-term investment cycles***

Investment in energy projects is a long-term proposition and in that context, investors face considerable risks and challenges, which vary by region and the stage of the energy chain. Overall, investment conditions must be appealing and returns high enough if they are to trigger the necessary investment. Energy investment requires a long-term view. Many options involve considerable time and expense to alter energy and raw material inputs and to develop and introduce technological changes. Business therefore encourages policy makers to commit themselves to a consistent policy framework taking into account long-term investment cycles.

#### ***Keeping all energy options open***

Long-term energy security calls for the utilisation of a variety of energy sources. National circumstances will best determine the mix of fuels which is necessary for energy security and sustainable growth in a given country. BIAC encourages governments to keep all energy options open, to avoid trying to choose “winners” and “losers” among technologies and to consider investment requirements for a range of options in the energy mix. The diversification of energy supplies and distribution, both by energy type and by source, is an important measure to help improve energy security.

#### ***A competitive, free and open market***

The macro-economic environment is a key driver of energy demand and energy investment. Economic prosperity and efficiency depend upon free and open markets as well as predictable and transparent regulatory frameworks that reduce competitive distortions. Governments play a major role in ensuring that adequate financing for energy infrastructure

can be mobilised in a timely fashion, notably by establishing enabling policy frameworks for the energy sector. Free and open markets operating within a clear, stable and well-designed legal, fiscal and regulatory framework are the foundation to avoid market distortion. Market-based prices, market solutions, cost-benefit analysis and a non-discriminatory and consistent legal enforcement are all attributes of these frameworks.

### ***Improving public governance***

Energy investors often face high risks of political uncertainties in a number of developing countries. In addition to free and open markets, other factors such as political and legal stability, transparency of regulation and rule of law, as well as the elimination of bribery, corruption and bribe solicitation emerge as crucial issues for the investment environment. Political stability promotes consistent policy frameworks to improve public governance, which in turn affects the planning basis for business development, investment decisions and cost-recovery in the longer term. This highlights the importance of increasingly involving non-member countries in discussions on energy investment and cooperation, and we encourage both OECD and IEA to reinforce their successful outreach work in this respect.

# I. Investment Challenges in the Energy Sector

## 1. The importance of energy for economic growth and development

### *Energy and economic growth*

Energy is an essential motor of social and economic development for an ever-increasing world population. Growth and development can be attained only if a secure, reliable and affordable supply of energy is ensured. Energy remains a strategic commodity, and ensuring its availability remains a key objective for national security and economic growth. An important consideration is that oil and gas resources are unevenly dispersed geographically. Furthermore, according to a recent study by the International Institute for Economics (IIE), approximately 77 percent of world crude oil reserves are controlled by national oil companies. New energy supplies to meet rising demands will increasingly lead to requirements from countries with large reserves.

Overall, energy prices remain an important determinant of global economic performance. As illustrated, for example, by the International Energy Agency (IEA) analysis of the impact of high oil prices on the global economy in 2004, oil prices matter to the health of the world economy. According to a quantitative exercise carried out by the IEA in collaboration with the OECD Economics Department and with the assistance of the International Monetary Fund Research Department, a sustained \$10 per barrel increase in oil prices would result in the OECD as a whole losing 0.4% of GDP in the first and second years of higher prices.

While the vulnerability of countries varies depending on the degree to which they are net importers, high oil prices have a negative net effect on the global economy by affecting economic activity, consumer costs, corporate earnings and inflation in importing countries. This illustrates the importance of taking due account of the energy dimension in discussions on economic growth, development and investment. It also underlines the importance of giving consideration to the possible impacts of tax policies affecting energy supply and use in a global context.

Suppliers' interests for attracting investment need to be taken into account along with the needs of small and large energy consumers. While governments have a crucial role to play in setting predictable policies and adequate framework conditions for investment in the energy sector, business is indispensable in helping ensure a secure and reliable energy system for all.

### *Keeping all energy options open*

Energy security is a broad concept, which significantly depends on the diversification of energy sources. A variety of options will be necessary to meet the needs of social and economic development. While new energy technologies may have a role to play in the future, fossil fuels, hydro and nuclear energy will remain predominant in the near to mid-term energy mixes. While new energy options can be expected at some point to affect the balance of the existing energy mix, it would not be realistic to anticipate a sudden and immediate changeover from existing major energy systems to new ones.

Long-term energy security therefore calls for the utilisation of a variety of energy sources in order to reduce exposure to sudden disruptions. National circumstances will best determine the mix of fuels – oil, gas, coal, nuclear or renewable energy – which is necessary to contribute to energy security and sustainable economic growth in a given country. BIAC encourages governments to keep all energy options open, to avoid choosing “winners” and

“losers” among technologies and to consider investment requirements for an appropriate range of options in the energy mix. The diversification of energy supplies and distribution, both by energy type and by source, is an important measure to help improve energy security.

### ***Improving developing countries’ access to energy***

Achieving development goals in the poorest countries will require greater access and improved energy services as a means to provide education, health, clean water and other societal needs. Making energy available to the almost 1.6 billion people who still lack access to electricity is a prerequisite to overcoming poverty, and presents a considerable challenge for governments and the energy industry in the approaching decades. The growing requirements of OECD non-member countries will undoubtedly create major challenges for global supply security. Current energy supplies will require commensurate development to support economic growth throughout the world.

Innovative energy technologies and major investments in energy infrastructure in developing countries are therefore of crucial importance. While governments continue to have an important role to play in fostering technology that can help address these challenges on a global level and in offering a framework of well-functioning and competitive markets, the engagement of the private sector for global dissemination of the necessary technologies is essential. The ability of energy project participants to secure local acceptance and build social trust is important to determine the extent to which new energy technology is successful in developing countries. Business is central to innovating and deploying advanced technologies that utilise energy resources more efficiently, improve product quality and enhance both environmental and end-use performance. One constructive step in this regard would be the liberalization of energy services in the WTO Doha negotiations.

### ***Energy in a sustainable development context***

The World Summit on Sustainable Development highlighted the need to dramatically increase access to affordable energy as a crucial enabling condition for achieving sustainable development. Predictable, accessible and affordable energy is not only crucial for economic activity, but it also contributes to social development and improves living standards in developing countries.

At the same time, energy can pose environmental and social challenges, including issues surrounding land use, global climate change, water and urban air quality. Actions to address climate change will have a significant impact and implications for energy policies, which in turn will have economic implications. Continuing research on climate science as well as technology to improve energy efficiency and development of energy supplies with lower levels of emissions should figure prominently in climate policy priorities. As energy demand increases around the world, it will remain essential to consider the trade-offs between the economic, social and environmental considerations to decide on the role that the various energy options should play in a country’s energy mix. Climate and energy policies should be integrated, long-term, market oriented, cost effective, and harmonious, fostering innovation and commercialisation of technologies.

Sustainable energy pathways will require broad societal consensus around integrated policies to advance economic, environmental and social development. According to their state of development, priorities, and available resource mix, countries will pursue different paths towards sustainable development. They involve different policy mixes incorporating fiscal, regulatory and research & development efforts. The best energy option will emerge when geographical borders have the least impact on reaching the most economic and sustainable solutions.

## **2. Investment challenges in the long-term**

### ***Investment requirements by 2030***

In its 2003 World Energy Investment Outlook (WEIO), the IEA estimated that total investment requirements for energy supply infrastructure worldwide over the period 2001-2030 are \$16 trillion. This investment would be needed to expand supply capacity and replace existing and future supply facilities that will be exhausted during the projection period. This figure illustrates the magnitude of the task that lies before us, and it is BIAC's hope that it will trigger governments to adopt policies that will help encourage the necessary investment flows.

While the world's energy resources are sufficient to meet projected demand, mobilising the required investments in the neediest regions will be a challenge for the coming decades and underlines the importance of a competitive energy sector that can attract the necessary investment. Financing energy investment cannot be taken for granted, and the key question will be whether conditions in the energy sector are right to attract the necessary investment with adequate incentives for investors. OECD countries will face considerable challenges to ensure the security of supply as well as transmission and distribution reliability. However, financing the necessary investment in developing countries with favourable investment requirements will remain the most daunting challenge. Governments can assist in this process by encouraging their official export credit agencies to support the financing of key energy infrastructure projects on appropriate credit terms, and by insuring private sector investments in such projects. Increased private sector investment will be required and governments will have a key role to play in promoting competitive energy markets and setting the right framework conditions for investment.

From a business perspective, access to secure and affordable energy involves a range of business actors in addition to the traditional sectors of power generation, utilities and natural resource extraction. Transport, grid maintainers, automotive and energy intensive sectors are essential parts of the energy supply and use chain. Their needs and operating realities have to be taken into account as decision-makers consider how to attract and retain the investment that will be necessary to meet the challenges of the WEIO's forecasted needs in developing countries.

### ***Taking into account long term investment cycles***

Investment in energy projects is a long-term proposition and in that context, investors face considerable risks and challenges, which vary by region and the stage of the energy chain. Overall, investment conditions must be appealing and returns high enough to trigger the necessary investment. Many options involve considerable time and expense to alter energy and raw material inputs, operations and products and to develop and introduce technological innovations.

For energy producing and large energy-intensive industries, equipment lifetimes often range from 30 to 50 years. With regular maintenance and newly available technology, capital stock can often last decades longer than its initial expected/proposed lifetime. New process technology, i.e., technology that improves the efficiency and cost effectiveness of a factory or power plant, requires performance improvements of an exceptional magnitude to induce a firm to retire equipment where capital costs have already been paid.

Furthermore, the planning basis for business development, investment decisions, and cost-recovery may be profoundly affected by governmental commitments and changes in the international framework in the longer term. Uncertainty regarding longer-term time frames has already introduced concerns and delays in decision making, especially regarding international investments for energy production and distribution projects to develop long-lived infrastructure.

Business encourages policy makers to commit themselves to a consistent policy framework over an appropriate period of investments, which in the energy sector can amount to several decades.

### **3. Key business messages in energy governance and investment**

#### ***A competitive, free and open market***

Governments will continue to play a major role in ensuring adequate financing for energy infrastructure and in encouraging private investment by establishing an enabling policy framework for the energy sector. The macroeconomic environment is a key driver of energy demand and energy investment as it affects not only the amount of investment needed, but also the energy sector's access to capital.

Economic prosperity and efficiency depend upon free and open markets and predictable and transparent regulatory frameworks which reduce competitive distortions. Free and open markets operating within a clear, stable and well-designed legal, fiscal and regulatory framework are likeliest to avoid market distortion and best serve the interests of business and society. Open markets across national borders have been a reality for decades in the oil and coal sectors, whereas integrated regional markets are a more recent experience for electricity and gas. Market-based prices, market solutions, cost-benefit analysis, non-discriminatory and consistent legal enforcement, risk assessment and sound science are all attributes of these frameworks. The use of market-distorting policies adds unnecessary costs to society, hampers efficiency and should be avoided.

Differences in taxation and in environmental and other regulations between different energy sources and jurisdictions can distort competition significantly and influence the investment climate. Therefore, policies should be carefully assessed for their economic burdens and cost-effectiveness before they are finalised and implemented. The possible impacts of tax policies in a global context, such as competitive distortions, need to be given due consideration. The OECD work on Regulatory Reform can be an important instrument to promote such policies.

#### ***Improving public governance***

Outdated regulations contribute to a bureaucratic, less efficient environment, often inhibiting the potential of private sector or foreign direct investment. Regulatory reform that encourages open markets and competition will have to overcome entrenched interests and this will require international dialogue, incentives and cooperation. Sound data and analysis are indispensable to this effort, particularly in order to identify patterns of regulatory reform that have been successful and sustainable in one or more member countries. A main focus should be on promoting the adoption of these approaches and on finding ways to bring these messages to the attention of relevant non-member countries.

Giving attention to the following concepts helps facilitate the promotion of efficient policies and well-directed investments:

- **Free market** - An economic system promoting individual business/property rights and freedom of entry, with market prices and profit-and-loss incentives used to allocate scarce resources to competing uses.
- **Open market** - Markets where barriers to entry are few, defined by an enterprise's competitive/financial capabilities and its profit-and-loss incentives and enabling an impartial, non-discriminatory environment for competing alternatives.

- **Market solutions** - A free market approach to determine solutions and prices to consumer, supplier, investor or government objectives. This is a more efficient alternative to government "command and control" regulatory approaches that set mandates and restrict potential options.
- **Cost/benefit analysis** – A quantifiable approach to account for and determine how the expected tangible costs (including foregone opportunities) of a policy, project or action compare with the expected tangible benefits. Regulatory Impact Analysis (RIA) is another useful tool to assess and seek areas in which to improve rule making.
- **Rule of law** - A system of government whereby a reliable and transparent framework of laws provides a common and stable foundation to promote law and order, protection of investors rights and protection of intellectual property, standards for personal and business conduct, and justice via due process.

Business should participate in policy discussions to help governments take a global and long-term view, pursue market-based solutions and support open competition. As predictability is best achieved through a consistent political framework, BIAC encourages governments to set long-term policy frameworks for energy investment.

### ***Transparency of regulation and policy instruments***

Business needs transparency of regulation and policy instruments. Non-transparent regulatory systems serve as a significant barrier to private investment. Transparency reduces risks and uncertainty while promoting consistency and predictability. It also minimizes corruption and discrimination, promotes competition, and strengthens accountability of governments.

The unique long-term and capital-intensive nature of the energy industry's investment and commercial activities, its price and revenue flows fluctuations, and its economic significance and impacts in the producer countries and world markets all depend on transparency. As energy sector investors face a particularly high risk of policy reversals and policy uncertainties in a number of developing countries, it is essential to enhance transparency, not only through national laws and regulations but also through international cooperation.

### ***Political and legal stability and strong institutions***

Political stability promotes consistent policy frameworks to improve public governance, which in turn profoundly affects the planning basis for business development, investment decisions, and cost-recovery in the longer term. Hence, political stability is a crucial requirement to encourage international investments for energy production, infrastructure and distribution projects.

A reliable regulatory and legal redress process can help reduce 'regulatory risks', which tend to be prevalent in developing countries. Business understands that full regulatory certainty can never be guaranteed. In fact, new information may require new approaches, for example, environmental or safety risks or unforeseen consequences of regulations that may emerge.

### ***Eliminating solicitation, bribery and corruption***

To promote investment in the energy sector, the business community sees a strong need to eliminate acts of bribery and corruption, which is a shared responsibility. BIAC believes that governments and inter-governmental actions have an important role to play in assisting companies in the prevention of bribe solicitation as well as in prosecuting offenders.

The OECD represents the majority of world investment activities and is well suited to assist governments in reducing bribe solicitation, based on experience and oversight of the OECD Anti-Bribery Convention. Convention-related outreach activities with non-member countries and initiatives on better governance and regulatory reform are very useful. The fight against bribe solicitation must be an integral part of the OECD's anti-corruption and regulatory reform activities with non-member countries.

### ***Infrastructure requirements***

Energy companies frequently require infrastructure that developing countries lack. In those instances, energy companies are expected or obliged to actually provide the lacking infrastructure (building roads, providing health care, etc.). In areas where there is a lucrative source of energy to be extracted, this is part of the business equation. In other areas where the economics do not allow this potential, the dynamic will be very different.

The availability of capital resources, including both up-front costs borne by project partners and basic infrastructure requirements, remains a challenge facing many energy proposals. Financial mechanisms to stimulate markets to make the necessary capital available are often in short supply in developing countries where they are most needed. This, of course, affects the risk portion of the equation. In addition, technical capabilities, human resources and cultural aspects strongly affect the viability of projects, and capacity building should be part of any project planning.

## **4. The importance of international cooperation**

For BIAC, which represents the broader business community, including both energy producers and consumers, the challenge is how economies can provide and use energy more efficiently with reduced environmental impacts, while maintaining economic growth and prosperity. In this context, how can necessary investment levels be reached? International co-operation is especially relevant in this respect and contributes to enhancing the overall efficiency of national efforts. Societies will benefit when governments and industry work together cooperatively and effectively.

The IEA plays a crucial role in addressing emergency preparedness, promoting rational energy policies in a global context through co-operative relations with its members, non-member countries, industry and international organisations and in contributing to discussions to improve the world's energy supply and demand structure. The OECD has the potential to bring these messages and policy recommendations to the attention of decision-makers in governments beyond the energy departments and raise the profile of the energy dimension in discussions on economic policy, investment, regulatory reform, innovation and its work with non-member countries.

The growing importance of non-OECD countries in global energy consumption has major implications for global supply issues as well as environmental consequences. Non-member countries should be engaged as essential partners in discussions on energy investment and co-operation, and we encourage both OECD and IEA to continue and reinforce their successful outreach work in this respect.

BIAC congratulates the OECD for initiating a dialogue with Energy Ministers on the topic on energy and investment during the 2005 OECD Council Ministerial. We encourage the Organisation to work towards increased policy integration and dialogue among ministries on this important issue and give due consideration to the energy dimension across a wide range of its ongoing activities.