



The Voice of OECD Business

From One Crisis to Another?

The Importance of Continuing Investment in Energy

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I. Introduction

For many companies around the world, the current financial and economic crisis signifies a time to save, not to invest. Companies are forced to make cutbacks and survive long enough until the economy begins to recover. However, while investment cutbacks are often necessary as a survival mechanism, reducing investment in the energy sector could seriously undermine broader economic recovery in the longer term, particularly in the context of rising energy demand and the growing importance of addressing climate change.

On the contrary, BIAC views the current crisis as an opportunity to reinvigorate investment. Investment in the energy sector must be helped back on track, and that will require major and urgent efforts from both the public and private sectors. The OECD and its sister agencies – the IEA and NEA – should make this a top priority.

II. Investment urgently needed to cope with rising demand

The financial and economic crisis has affected the energy sector at a time when the sector is already facing other concerns regarding security of energy supply. Two long-lasting trends that will cast a long shadow on the sector's future are rising energy demand and rising energy-related carbon dioxide emissions.

The International Energy Agency (IEA) has estimated that, based on current government policies, global demand for primary energy will grow by 45% between 2006 and 2030, requiring USD 26 trillion of cumulative investment¹. This is particularly important for countries where many existing oil and gas basins are depleting rapidly, necessitating further exploration and infrastructure development. Meanwhile, global energy-related carbon dioxide emissions are set to also grow by 45% in this timeframe unless new policies are put in place.

Major inflows of investment in the energy sector were therefore already needed before the current financial and economic crisis gripped the global economy. The crisis, however, has

¹ International Energy Agency (IEA) 2008 World Energy Outlook.

amplified the investment problem. It has led to major investment cuts in the energy sector, which could jeopardise governments' efforts to tackle rising energy demand and carbon dioxide emissions.

III. The consequences of the crisis for energy investment

Since the crisis began to weigh on the global economy, investments in the energy sector have been significantly reduced compared to previous years. The IEA estimates that global upstream oil and gas investment budgets for 2009 have been slashed by over 20% compared with 2008, signifying a reduction of almost USD 100 billion². And despite countries' efforts to switch to "greener" energy sources, investment in renewable energies is estimated to fall by as much as 38% in 2009.

All of this spells major problems for addressing the general trends of rising energy demand and carbon dioxide emissions. The crisis is resulting in delays or blocks on new fossil fuel extraction projects, refineries, pipelines, grid expansions and power plants, as well as delayed deployment of more energy-efficient equipment. Several planned major upstream oil and gas projects have been recently postponed or cancelled due to fewer funds for exploration.

As for renewable energies (such as solar, wind, biofuels, etc.), most have been rendered less competitive due to the currently lower costs of fossil fuels, thus deterring investment in these areas. Meanwhile, less investment into the research and development of cleaner, emerging energy technologies will delay their entry onto the market. Furthermore, energy consumers (businesses and households) are reportedly delaying paying for new energy-efficient equipments, buildings and appliances, as lower incomes and lower energy prices act as counter-incentives.

On the other hand, however, the crisis is expected to have reduced energy demand for 2009, the first annual decline since the end of the Second World War. At a time when companies are cutting back, this drop may come as a slight reprieve, putting less strain on existing capacity in order to meet demand. But this calmer period should be exploited to invest in future production and infrastructure that will be much-needed when the economy (and energy demand) rebounds, particularly as some resource-rich countries may now feel more in need of foreign investors. Failure to invest could lead to another episode of escalating energy prices in a few years time, which could impede the overall recovery of the global economy.

IV. Barriers to investment in energy need to be urgently addressed

If countries are to reverse the downward fall in energy investment and seize new opportunities, they must identify and remove the barriers to investment.

² IEA (2009) "Launching an Energy Revolution in a Time of Economic Crisis: the case for a low-carbon energy technology platform".

In BIAC's view, while not the only barrier, one of the obvious ones is the lack of available credit. Financially-stretched projects and companies have had to scale-back. This predominantly impacts small- and medium-sized enterprises, which often experience more difficulty in gaining access to credit and many of which have had to sell out to more established enterprises. Many banks have also shortened the period for loan payments (some only allow five years or less), making long-term financing for infrastructures particularly difficult.

Meanwhile, the turbulent and unpredictable energy markets have led many venture capitalists and private equity investors to pull out from projects. Falling energy prices (particularly oil) have made new investments in production facilities less profitable, while investment costs have generally remained high. This creates an unattractive investment environment.

In addition, lack of policy predictability in some countries acts to significantly deter investors, particularly as energy projects are often long-term in their nature. BIAC believes that choosing winners and losers and engaging in a "subsidy race" between countries or sectors is also detrimental to investment and the diversification of energy sources. Similarly, continued discrimination by some countries towards foreign investing companies is reportedly deterring much-needed investment in energy infrastructure. Other barriers include administrative hurdles and poor grid planning (such as unnecessarily long approval procedures for grid development). Poor communication of information to the public and social acceptance issues, concerning, for example, new coal plants, nuclear energy, carbon capture and storage (CCS), biofuels, and so on, also pose significant investment challenges.

V. Build the right policies to boost energy investment

In view of the difficult economic situation, it is more essential than ever to create an investment-friendly regulatory environment. In the short-term, governments can play an important role by boosting investment in the energy sector, as the private sector is still reeling from the impacts of the crisis. However, in addition to allocating public funds to "kick-start" investment in the energy sector, the main role of governments should be to remove investment barriers and create a policy framework that encourages private sector investment in the energy sector.

Achieving the right balance of public funding is not an easy task. Public sector investment should follow market principles and help create the necessary enabling environment for private investment which will follow once economic recovery begins to pick up or once investment barriers are removed.

However, public sector investment should not distort market competitiveness. Long-term public subsidies for certain types of energy production need to be carefully evaluated and eventually removed where market distortions occur. Similarly, public subsidies for the use of energy by consumers in some countries are often not consistent with the goal of achieving energy efficiency or achieving effective energy pricing systems.

The idea for the public sector to invest in the energy sector during the crisis is not new – many government stimulus packages have already included funds directed at clean energy and energy-efficiency, totalling USD 100 billion to date³. Yet much more will need to be done in order to meet energy supply and climate change objectives.

Governments' resources, however, are also limited, and their public funding will only go so far. The key to improving investment in the energy sector will eventually come from enabling the private sector. The role of governments should thus be to introduce policies that tackle the barriers to investment and offer incentives for the private sector to pursue certain projects. Governments should improve the access to credit, particularly for small- and medium-sized enterprises, and in the context of the current crisis should consider the use of loan guarantees, clean energy bonds, and tax incentives.

In BIAC's view, an enabling policy framework should also include the following: a system of government whereby a reliable and transparent framework of laws provides a common and stable foundation to promote law and order via due process; an economic system promoting individual business/property rights and freedom of entry; markets where barriers to entry are few and primarily defined by an enterprise's competitive/financial capabilities; and a free market approach to determine solutions and prices to consumer, supplier, investor or government objectives.

From the business perspective, policies should look to the long-term with a view to providing more stability and predictability for private sector investors. Business as well as other key stakeholders should be thoroughly consulted when forming national energy policies. In our view, policies should consider the full range of possible energy options, including fossil fuels, renewables, nuclear energy, etc. in order to maximise energy security. Public-private partnerships will be crucial for boosting energy investment, particularly in important emerging technologies such as CCS. Governments should also work to make energy policies more efficient and thus reduce burdensome administration (for example, by shortening approval procedures for grid development). Concerning social acceptance of certain energy types, such as new coal plants, nuclear energy, and CCS, politicians should be more willing to demonstrate their support on the local level for potential investors whose investment will contribute to energy security.

VI. Addressing climate change must remain a key objective

While it will be essential to boost investment in the energy sector to meet demand, it is crucial that new investment also functions to address climate change. The crisis has had a worrying impact on investment in the “cleaner” energy and energy-efficiency technologies, undermining some efforts to reduce carbon-dioxide emissions. Projects dependent on these technologies are currently receiving less investment, as their markets are less proven and as financial resources are scarce. In addition, falling fossil fuel energy prices have meant that renewable energies are becoming less competitive vis-à-vis fossil fuel alternatives. In such

³ IEA Press Release “IEA says that G8 call for increased investment in energy supply, energy efficiency and low-carbon technology is timely and urgent”. July 9, 2009.

an environment, investors are often less keen to invest in the energy efficiency market if it is perceived as too risky. However, in view of the immense challenges we are facing in trying to tackle climate change, such investments are crucially needed.

In light of the crisis, the OECD business community underlines that it is therefore more important than ever to carefully target investments and to seek ways to enhance efficiencies. In view of rising emissions, there is a need for breakthrough technologies, which require global cooperation and support for research and development. Public-private partnerships for technology cooperation and capacity building should be encouraged. At the same time and as illustrated by a number of IEA studies, investment in energy efficiency holds major potential for reducing carbon-dioxide emissions and should remain a top priority for policy makers and the private sector.

Despite the negative impacts of the crisis on the world's efforts to address climate change, and in view of the upcoming Climate Change Conference in Copenhagen, business remains committed to addressing climate change as a top priority. This should be reflected in their long-term investment decisions.

VII. The role of the OECD, IEA, and NEA

BIAC welcomes the recent analyses and recommendations put forth by the OECD, IEA and NEA with respect to the current economic crisis, including implications for the energy sector. The June 2009 OECD Ministerial Declaration on Green Growth, for example, is an important step forwards, considering economic growth and environmental considerations together.

In BIAC's view, the OECD's multi-disciplinary expertise, covering corporate governance, financial regulation, foreign trade and investment, structural reforms for economic growth, macroeconomic policy, regulatory quality, tax, as well as competition and consumer policy, is of fundamental importance in forming policy responses to the economic crisis. It is important to consider policies on all of these issues together when planning investment strategies for the energy sector. In addition to their unique ability to take a holistic approach to addressing global economic issues, the OECD, IEA and NEA offer a wealth of renowned empirical evidence to support their policy recommendations. In the case of energy investment, this is important for encouraging policymakers and companies to invest in new projects, and can also help with social acceptance issues. Finally, the OECD's well-established dialogue with its advisory bodies, BIAC and TUAC, contributes to the quality and credibility of OECD work, and generates interest in the private sector that can help investment issues.

The IEA has been instrumental in providing fact-based analysis of energy investment trends, and its contribution to the G8 Energy Ministers Meeting in May 2009 set out clear priorities for governments in order to boost investment in the energy sector. We look forward to the IEA Ministerial in October 2009, whose focus on partnerships underlines one of BIAC's key messages in this paper: that both governments and business will need to act in unison in order to revitalise investment in the energy sector. We encourage the IEA to continue to prioritise its stocktaking exercises and future forecasting models in order to chart and

estimate the course of energy investment and the steps that should be taken to bring improvements.

The OECD, IEA and NEA should continue to work closely on the issue of energy investment going forwards in order to pool their collective data and expertise, and establish policy recommendations. BIAC stands ready to provide business input to the OECD, IEA and NEA in their future activities on energy investment issues.

VIII. From one crisis to another?

The impacts of the current economic crisis on the energy sector have been profound. Investment in the energy sector is suffering, further intensifying the already-existing problems of rising energy demand and carbon dioxide emissions. Yet new investment opportunities should be sought to ensure the security of supply. Short-term crisis-related funds will be necessary and will help, but they will only go so far. BIAC feels that governments and business must also work together to revitalise investment with a post-crisis vision. These efforts will only work if they are built on a bedrock of enabling policies that mobilise and encourage private sector investment. If not, there could be yet another crisis on the horizon.