

Presentation of the Secretary General Dr. Ria Kemper
Symposium on the Energy Situation in China and Energy
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Mr Chairman, distinguished participants in this symposium, it is a great pleasure for me to be here to present the perspective of the Energy Charter Secretariat on energy cooperation in North-East Asia. What I propose to do in my presentation is to focus on three main themes.

Firstly, I would like to identify some key issues that would need to be addressed by governments in developing a framework for energy cooperation in North-East Asia; issues that can be considered essential building blocks for a regional and multilateral approach.

Secondly, I will look at the Energy Charter process as a mechanism for inter-governmental cooperation on energy issues, and address in particular the crucial role of Russia in Eurasian energy affairs. In doing so, I will try and highlight some historical aspects of the development of the infrastructure bringing Russian energy resources to Europe, and to examine what lessons this experience may hold for the North-East Asian region.

I will conclude with some observations on the relevance of the Energy Charter Treaty and the Energy Charter process for today's discussion.

To begin with, and by way of providing the context for my presentation, I would like to refer to a very important and welcome milestone in international affairs, that is, the entry into force of the Kyoto Protocol one month ago. I think that this demonstrates two points that are of clear relevance for today's discussion. Firstly, it shows that the constructive willingness of the Russian Federation to subscribe to multilateral agreements on energy and the environment. Secondly, it suggests the importance of natural gas as the bridge to future reductions in greenhouse gas emissions. I firmly believe that gas will emerge as the fuel of choice for meeting rising energy demand in the 21st century, and that this will be particularly important in Asia where overall reserves are plentiful but - up until now - gas has played a relatively minor role compared to other regions of the world.

Looking at the North-East Asian region, the region's major energy-importing economies - Japan, China and the Republic of Korea - share a common interest in reducing their present reliance on energy imports from the Middle East, through diversifying the range of energy resources they consume. This leads to a common interest in developing cooperation with Russia, which has the potential to become a major supplier of energy - in particular of natural gas - to consumer markets in North-East Asia. Russia, for its part, is actively looking to expand its energy export potential in Asia, given the relative proximity of its major oil and gas reserves in East Siberia and Sakhalin to the Asian market.

In this way, we have as a starting point a clear mutual interest in projects designed to increase energy flows within the North-East Asian region. The potential for increased cross-border flows in this region has been well documented. Besides the economic and environmental advantages of increased use of natural gas in the overall energy mix, the long-term relationships that must accompany increased trade in natural gas can make an important contribution to regional stability. However, in order for this enticing vision to become a reality, huge long-term investments will be required - primarily from the private sector - to create the infrastructure that can bring energy resources from Russia to Asian consumer markets.

The main question that I will be examining in my presentation is the following: what can governments do collectively - including through the work of international organisations - to create stable conditions for investment, and also to create a stable regional framework for projects involving cross-border energy flows?

Let me start my answer by identifying some of the key issues that will need to be addressed. First and foremost among these is the need to develop a political consensus among a diverse group of countries in North-East Asia on the principles that will govern their cooperation. In this regard, I would suggest that these principles should include the following:

- A clear and high-level recognition of the mutual benefits of increased cooperation in the energy sector, and secondly;
- A commitment to the development of transparent, rule-based and sustainable energy markets, with access to international markets on commercial terms.

Considering measures that would be needed to bring this political commitment to life, a first area that needs to be addressed is the conditions governing investment, in order to attract the flows of international capital necessary for regional production and infrastructure projects. By reducing or removing specific non-commercial risks, governments of the region can play a significant part in fostering the confidence that can support major investment decisions by private industry and the financial community. The more that these mechanisms for risk reduction are legally binding - and reinforced by access to international arbitration in case of disputes - the greater the impact on investor confidence.

A second area relates to measures promoting more transparent and competitive energy markets, in particular relating to the reliability of cross-border flows between producer countries and consumer countries. In this respect, it is possible to distil from the experience of energy cooperation in the Western part of Eurasia some core issues that can serve as a foundation for strong regional cooperation also in the Eastern part of Eurasia, while retaining sovereignty for the participating states over national energy market structures and policies. As a first step, I would suggest the following:

- A shared commitment to security and non-interruption of supply, based on the principles of non-discriminatory treatment and promotion of cross-border energy flows;

- With regard to cross-border flows, a commitment to transparent and market-based pricing mechanisms.
- A third crucial element of a regional strategy would be a common pledge to cooperate in promoting the efficient use of energy, through programmes and policies on improving energy efficiency.

In my view, a strategy incorporating these three elements - measures to protect investments and to secure cross border energy flows, to encourage more transparency and market based pricing, and to promote energy efficiency - would be a useful starting point for governments of North-East Asia that are looking for a strategy to enhance their cooperation in the energy sector.

On this basis, I would now like to turn to the example of the Energy Charter Treaty and the Charter process as a framework for regional cooperation. As you are aware, the Charter process emerged in the 1990s out of awareness across Europe, in the Russian Federation and in the countries of the Caspian and Central Asia of shared and complementary interests in the energy sector. This was not only an economic interest; it was also based on the conviction that a strong and mutually beneficial set of relationships in the energy sector would help to strengthen the new political ties across the Western part of Eurasia and provide a means to overcome previous divisions and rivalries.

The Energy Charter Treaty, which has been signed by fifty-one countries including producer, transit and consumer states across Europe and Asia, is living proof that diversity is no barrier to energy cooperation. Two weeks ago, I had the pleasure to participate in a Round Table in Ashgabat, Turkmenistan, organised by the Secretariat together with the Government of Turkmenistan and the European Commission, and I was impressed by the importance that the Turkmen government attaches to the principles of the Charter Treaty and to cooperation in the Energy Charter process. Particularly in Central Asia, the Treaty stands out as one of the very few international frameworks that bind this region to the broader Eurasian space.

This distinctive profile is based on the fact that the Treaty is the best available multilateral framework for the protection of investments in the energy sector, and that its provisions are supported by access to binding international arbitration. Awareness of these mechanisms for the resolution of investment disputes is growing within the international legal and energy community; the first arbitration award under the Treaty was made in December 2003 in a case between a Swedish investor and Latvia, and a number of other cases are pending. The Secretariat is committed to promoting this awareness, and as an example I would like to point to a major conference on investment arbitration and the Energy Charter Treaty, which we are organising in June in Stockholm together with the Arbitration Institute of the Stockholm Chamber of Commerce.

The Treaty also provides a legal instrument to facilitate and promote more transparent international energy markets and to protect cross-border flows. I would highlight in this respect the pioneering role of the Treaty in providing multilateral protection for cross-border energy flows, and particularly for energy flows in transit. As you may know, we have been engaged in an attempt to strengthen the existing

provisions of the Treaty in this respect, through the negotiation of an additional Protocol on Energy Transit. As of today, there remain a small number of outstanding issues in the draft text of the Protocol, all of which are the subject of continuing discussions between the European Union and the Russian Federation. It is nonetheless significant that we have already reached a large degree of consensus among our member states on key elements, most notably on the definition of 'available capacity for transit', on the obligation to negotiate access to this capacity on a transparent and commercial basis, and on the principle that transit tariffs be cost-based and non-discriminatory. I would like to note the strong dialogue that we have developed on these and other issues with representatives of the energy industry, including Gazprom.

The Charter process also provides a successful forum to analyse, discuss and promote policies aimed at greater energy efficiency, based on a shared political commitment to sustainable energy use.

A final observation in relation to the Charter process regards its scope and geographical coverage. As I noted earlier, the initial focus was on relations across the Western part of Eurasia that emerged after the end of the Cold War. However, since then the Charter has taken on a broader Eurasian perspective, and the importance of the Asian dimension of the process was greatly strengthened by the ratification of the Treaty by Japan in 2002, by the accession of Mongolia as a full Contracting Party, and also by the acquiring of observer status by China in 2001, South Korea in 2002 and the ASEAN group of countries in 2003. I should note also the recent developments in South Asia, where discussions on new regional pipelines have stimulated interest in the Charter framework from both India and Pakistan.

A common denominator for both a European and an Asian perspective on the Charter process is the importance of cooperation with the Russian Federation, and it is to this topic that I would now like to turn. Russia has strong economic incentives to develop its oil and gas reserves in Eastern Siberia and to bring them to the promising markets in Japan, China and Korea. This is a central element of broader strategic objectives to promote the development of so far untapped resources, to provide a diversification of its customer basis and to promote the economic and social welfare of this region. Being green field developments, they will require the construction of completely new energy supply infrastructure. A key element to ensure the commercial viability of various projects designed to bring these resources to market is the mitigation of various non-commercial risks that can deter investment by raising the cost of capital.

In this regard, it is worth considering the different circumstances that accompanied the development of Russian gas exports to Europe, and the prospects for new green field infrastructure that could serve markets in North-East Asia. The pipelines bringing Russian gas to Europe were largely put in place in the 1970s and 1980s, before the fall of the Berlin Wall. These were massive state projects, made at a time of complete central control of the Soviet gas industry. Supply obligations were guaranteed by the Soviet Union, and dispute settlement mechanisms were agreed between a mix of state-owned and private companies in Western Europe, on the one

hand, and Soyuzgazexport as a part of the Soviet government, on the other. International financing needed for these projects came from Western banks and was secured against income from sales contracts with large and creditworthy European companies.

Today, the North-East Asian region - including Russia - faces a changed environment for the development of regional energy infrastructure. The first new competitive challenge comes from LNG, and the possibility that - if pipeline gas is not available within a relatively short period of time - Chinese and Korean markets may satisfy their increasing demand by turning to imported LNG instead.

A second new challenge relates to the appropriate instruments for mitigating risk. Although there is a continuing strategic debate on this issue, it is undeniable that there is a new interface in Russia between the state and private or partly private companies, and so there is a corresponding need for new mechanisms for reducing risk, since commercially-driven investments with substantial private financing will need strong protection against government interference in their operation and in the fulfilment of energy supply obligations. On this point, I would argue that the Energy Charter Treaty provides the best available multilateral instrument for this new environment, since it is able to provide instruments of international law instead of previous risk-reduction mechanisms that depended entirely on a centrally planned state.

In saying this, I acknowledge the continued reality that the Russian Federation has yet to ratify the Energy Charter Treaty. But, at the same time, Russia is an active participant in the process, a commitment that was underlined by the nomination of the deputy Minister of Industry and Energy, Mr Ivan Materov, to serve as the Vice-Chairman of the Energy Charter Conference in 2005; another representative of the same Ministry has recently been confirmed as Vice-Chairman of the Charter's Working Group on Trade and Transit. It is also important to underline that Russia does apply the Treaty provisionally, and that this already provides an important measure of protection to foreign investments.

From the perspective of the Charter process, the development of energy investment and cross-border flows across Eurasia requires a sustained and open dialogue with the Russian government and with the key players in the energy industry, on the basis of the common principles set out in the Charter Treaty. This dialogue is facilitated by the fact that Russia does have a strong stake in the process, having participated from the beginning in the negotiation of the Treaty and all subsequent discussions. As the Russian Foreign Ministry noted last year, the Treaty 'represents a product of mutual compromises and concessions, reflecting the wishes of the Parties to find a balance of interests'. A continued effort from all sides to pursue this balance of interests is the key to an effective framework for regional cooperation.

Mr Chairman, I would like to conclude by summarising the different elements that I have raised in this presentation thus far. A major challenge for North-East Asia is to put in place a regional framework for securing investment and cross-border energy flows that will support the development of the region's huge potential. I believe that a multilateral approach to this issue is essential, and note of course that the major

partners in North-East Asia include three signatories of the Energy Charter Treaty - Russia, Japan, and Mongolia - and two countries with the status of observers - China and South Korea.

I have suggested that any strategy of regional energy cooperation will require a body of common rules, covering key issues such as the protection of investments, the encouragement of more transparent and competitive markets, and the promotion of energy efficiency. The Energy Charter Treaty provides just such a foundation of rules in these key areas, which can facilitate regional political discussion and dialogue on energy policy issues, and also support the emergence of a North-East Asian Energy Community.

In considering the perspectives for North-East Asian energy cooperation, I would therefore conclude with the proposition that full participation by all the countries of the region in the Energy Charter framework could provide an optimal and ready-made platform for closer regional ties in the energy sector. From the Secretariat, I also take this opportunity to assure you of our interest and readiness to continue the dialogue with you on the role the Energy Charter Process could play for the energy cooperation in North East Asia.

Thank you for your attention.