

“Increasing Mutual Dependence and Global Energy Security: The Importance of the IEA-Russia Energy Dialogue”

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Distinguished guests, ladies and gentlemen, thank you for the opportunity to take part in this 3rd International Energy Week in Moscow. In the next few minutes, I would like to share with you some thoughts on the outlook for oil and gas markets, key challenges to energy security and possibilities for further IEA-Russia dialogue.

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Let me begin with a few words on the global oil market, including prices. Since August, we have seen a retreat from the record price highs of early July. Although recent financial market turmoil and a reduction in oil market liquidity have made prices volatile, the overall trend has been clearly downward.

IEA analysis has for some months suggested a potential easing in fundamentals for the second half of 2008 and into 2009. Bearing in mind the toll that very high commodity prices have taken on the economy, this easing gives welcome breathing space. Inventory cover has moved higher as demand has weakened, and spare capacity is less tight than it was. But prices remain high by historical standards, as made abundantly clear in this graph.

And there remain plenty of risks on the supply side, which could derail this otherwise comforting short-term picture. In particular, we are seeing worrisome signs about the ability of some key oil producers, including in Russia, to find the investment funds needed to meet growing global demand. Credit shortages are becoming yet another impediment to upstream investment, alongside existing issues such as access restrictions, tightening fiscal barriers and capacity constraints. This suggests that further expanding production capacity could become even more difficult.

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In recent months, several factors have caused us to revise down our 2008 demand numbers. In addition to the high prices of the summer, we now see OECD demand being affected by weakening economic prospects and, most recently, by the spiralling liquidity crisis.

But, at the same time, the ongoing issues of decline, project delays and geopolitics have also lowered our expectations on the supply side. This is supported by the findings of the 2008 *World Energy Outlook*, which will be released in early November and which includes for the first time an analysis of decline rates in 800 oil fields globally.

So, while we see a less tight market in 2009 to 2010, we expect the spare capacity cushion to remain worryingly low towards 2013, as outlined in our *Medium-Term Oil Market Report*, released in July 2008. This would suggest that prices are unlikely to return to the levels of a few years ago any time soon.

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We must also bear in mind that while demand is falling in OECD countries, it is continuing to grow elsewhere, particularly in China, India and the Middle East. Although international financial developments suggest that a degree of non-OECD slow-down is likely, it is by no means certain that growth will be choked off altogether. We have yet to see unambiguous evidence of a sharp slow-down from China, while Middle Eastern demand growth remains robust. So we need to be wary of becoming complacent about the recent weakening in prices.

This is supported by the longer term picture. The forthcoming *World Energy Outlook* suggests that China, India and the Middle East will account for more than 80% of increased global oil demand to 2030, with China alone accounting for 43%. This strong demand trend is welcome as it reflects economic growth. In this context, eastern markets will clearly be a focus for Russian development in years to come.

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Alongside this, we see Russia's supply growth slowing with overall exports projected to decline in the next decade. In terms of the sustainability of Russian oil production growth, we see that production in Russia is mainly based on brown-field development and that the production rate at existing fields is declining. There is too little work or focus on greenfield developments. This will be the key for future supply to replace the declining production at existing fields.

Given the challenge ahead in East Siberia and the North, it is not obvious that investment incentives are adequate. This is all the more concerning given the cost inflation we have seen across all oil producing regions over the past years and the current disarray in global financial markets. In this regard, I note that further government efforts to facilitate investment would be welcomed, and would also be consistent with the Global Energy Security Principles agreed to by the G8 at their St. Petersburg G8 Summit in 2006.

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The IEA has similar questions about Russian gas investments – especially given the turbulent financial markets and the impact this may have in acquiring long-term credit. As you can see from this chart taken from Gazprom, the massive volumes of projected natural gas supplies in Russia are expected to come from new, more costly and difficult to develop fields.

It is encouraging to see that Gazprom has announced significant increases in its capital spending budgets next year. But it is perhaps not yet clear if these will be enough to match the higher cost of fields that need to be developed. Russia is the world's largest gas producer and exporter. Timely investments in upstream are critical to meet growing domestic gas demand as well as strong demand growth in Europe.

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So with projections clearly showing energy demand outstripping supply in the medium term to long term, energy security remains a vital issue. To ensure energy security, it is essential that we have more transparency of information – so as to reassure consumers that timely investments are being made. Such

transparency is also needed to reassure producers that growth in demand will continue despite policies and actions to enhance energy efficiency, use of renewables and more climate friendly technologies.

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Another important issue is the need to address climate change. While energy demand is outstripping supply, our *World Energy Outlook* shows global fossil fuel use continuing to drive up CO₂ emissions – with an increase of 57% between 2005 and 2030. The challenge we face is to promote economic development and greater access to modern energy services, while consuming substantially less energy per unit of global product. Everyone has a role, and no policy or technology option can be set aside.

The technologies that we need to reach a sustainable energy path already exist or are under development. The costs are significant but not beyond reach. But strong government policies – working with industry and the public – and close co-operation between the developing and the developed world will be needed.

The IEA's recent publication, *Energy Technology Perspectives*, shows that to reach the G8-endorsed goal of reducing CO₂ emissions by 50% by 2050 is achievable but extremely tough. This would see us reduce to 14 Gt in 2050 from current business as usual projections for 2050 of 62 Gt of CO₂ (from 27 Gt in 2005).

The most crucial step for achieving these CO₂ reductions is to ensure that the promise of technology is fully realised. In particular, we must: 1) improve energy efficiency, 2) decarbonise the power sector; and 3) revolutionise the transportation sector.

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Realising this goal requires a greater focus on energy technology R&D and international collaboration. One way to do this is through the IEA-coordinated 'Implementing Agreements' for energy technology, which aim to enhance energy technology information exchange and R&D. Currently, more than 5,000 scientists, policy makers and industry experts are involved in these 42 agreements, each of which creates a voluntary, jointly-funded energy technology research group. Importantly, all of these groups are open to

entities from IEA and non-IEA countries alike, and more Russian participation would be warmly welcomed.

Like energy efficiency, energy technology collaboration is another resource that Russia can tap into – to close the technology gap and to enhance its own energy security. What is more, through such actions, Russia can help to further *global* energy security, given its key role as a global energy consumer and producer. For this reason, the IEA welcomes enhanced engagement with Russia on energy technology collaboration – through the Implementing Agreements as well as through other channels.

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Let me close by emphasising that the world's energy economy is on an unsustainable pathway. The next *World Energy Outlook* indicates that fossil fuels will remain our predominant energy source until at least 2030, and yet it is very clear that the age of low price energy is over. It is vital that we address the twin challenges of ensuring secure, affordable energy, while also responding to climate change. In light of these twin challenges, enhanced investment, more efficiency, increased diversity and greater transparency in energy markets are essential, *and* will be beneficial to both energy consumers *and* producers.

Policy makers must set a stable and predictable policy framework within which industry can respond. Decisions have to be taken now and implementation has to begin now. The primary scarcity facing the planet is not of natural resources, nor of money, but time.

I thank you for the opportunity to address the conference today and wish you fruitful discussions.