Securing energy investments in the MENA region

A EURELECTRIC 8-step Action Plan

May 2015

EURELECTRIC is the voice of the electricity industry in Europe.

We speak for more than 3,500 companies in power generation, distribution, and supply.

We Stand For:

***Carbon-neutral electricity** by 2050*

We have committed to making Europe's electricity cleaner. To deliver, we need to make use of **all low-carbon technologies**: more renewables, but also clean coal and gas, and nuclear. Efficient electric technologies in **transport and buildings**, combined with the development of smart grids and a major push in **energy efficiency** play a key role in reducing fossil fuel consumption and making our electricity more sustainable.

***Competitive** electricity for our customers*

We support well-functioning, distortion-free **energy and carbon markets as** the best way to produce electricity and reduce emissions cost-efficiently. Integrated EU-wide electricity and gas markets are also crucial to offer our customers the **full benefits of liberalisation**: they ensure the best use of generation resources, improve **security of supply**, allow full EU-wide competition, and increase **customer choice**.

***Continent-wide** electricity through a coherent European approach*

Europe's energy and climate challenges can only be solved by **European – or even global – policies,** not incoherent national measures. Such policies should complement, not contradict each other: coherent and integrated approaches reduce costs. This will encourage **effective investment to** ensure a sustainable and reliable electricity supply for Europe's businesses and consumers.

EURELECTRIC. Electricity for Europe.

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KEY MESSAGES:

1. **Make regulatory agencies fit for purpose: put in place an enabling regulatory environment:** While arbitrating fairly between consumers, producers and investors, regulators should put in place clear rules that boost investors' confidence in generation and infrastructure projects.
2. **Enable cost-reflective energy prices – remove domestic electricity subsidies:** Phasing out subsidies, ensuring fair prices that reflect the real cost of electricity products and improving efficient energy use have become imperative to stimulate investment to attain the domestic growth goals.
3. **Formulate sound and transparent energy policies:** Investors need transparency on national energy strategies, on markets, the choices made in this context, and the rationale for those choices.
4. **Facilitate technical and political coordination and cooperation on grid investments: I**t is important to urgently develop and enhance new and existing interconnectors in the region in order to ensure security of supply for interconnected coupled countries and to support economic optimisation.
5. **Open market structures, in particular for RES generation projects:** Deregulation within national and regional energy markets is important to allow free entry and exit of new players and to create and facilitate competition among providers, in particular for the development of large-scale RES generation projects.
6. **Design and implement the right financing mechanisms to stimulate exploring the RES potential:** MENA country governments should design the right investment incentives that drive private investment to take advantage of the private sector's financing capacity, to profit from technology transfers and to benefit from positive environmental externalities.
7. **Improve education and technological transfer:** There is a need to develop strategy further by providing dedicated training for key energy decision makers within the MENA countries in order to improve competence and share knowledge and information between EU member states and the region.
8. **Enhance the EU-MENA Energy Cooperation: extend the Energy Community concept towards the South:** Within the framework of the Energy Union, there is now a clear opportunity for the EU to become more aware of its role and influence in the MENA region and start thinking about long-term engagement**.**

NE Ad hoc group Neighbourhood: Energy Community and MENA,
Anna ZVOLIKEVICH

Contact:
Koen Noyens, Advisor, Environment & Sustainable Development Policy Unit, knoyens@eurelectric.org

Many of the countries in the Middle East and North Africa (MENA) region are confronted with the unprecedented challenges of a growing population, surging demand for electricity, and the acute need for improved infrastructure. The MENA region is forecast to account for the majority of the world's energy demand growth well into the 2030s and beyond.

However, the region faces too limited investments in new generation capacity and distribution, and certain countries have limited or no supply of indigenous hydrocarbon resources. Furthermore, many countries in the region have recently set ambitious targets to revise their energy strategies and are increasingly turning to renewable energy and energy efficiency measures. They have also started implementing the regulatory reforms required to achieve these targets, albeit at different implementation programs and speeds.

EURELECTRIC has undertaken a survey with its MENA members to assess the current energy investment climate in the Mediterranean region. In the following, we present the European electricity industry's policy recommendations on how to secure investments in the MENA region.

I. Make regulatory agencies fit for purpose: put in place an enabling regulatory environment

Heightened political uncertainty and political crises in a number of countries in the region have adversely impacted investor confidence and foreign direct investment over the past year. Reducing this uncertainty is essential to ensure that the ambitious investment challenges can be met. A first prerequisite to a stable investment climate is therefore the establishment of a capable, independent, determined and empowered regulator.

It is widely agreed that stable, fair, cost reflective and performance based regulation leads to much lower investment risks and hence to larger investments, improved choice of contractors and lower financing costs. At the same time, a properly functioning regulator should guarantee that consumers benefit from sustainable investments, more transparency and better quality of service with reasonable electricity prices.

All in all, independence represents the essence of regulators' mission, along with the need for autonomy and accountability in their decision-making process. While arbitrating fairly between consumers, producers and investors, regulators should put in place clear rules that boost investors' confidence in generation and transmission and distribution infrastructure projects.

To successfully fulfil their role, regulatory agencies should take care to foster relevant capacities and competences. Further twinning and exchanges in international regulatory bodies like MEDREG and ACER could be a useful step in this regard.

In the longer term, regulators of neighbouring countries, or of countries hosting common infrastructure, could work to harmonise rules, including through the opening of access to infrastructure on a non-discriminatory basis, thereby fostering further investment in upstream resources.

II. Enable cost-reflective energy prices – remove domestic electricity subsidies

At present, electricity prices across most MENA countries tend to be too low for investors to recover the cost of generating electricity. Electricity subsidies in the MENA region widen the price gap between the costs of producing and the price of electricity for consumers. Unfortunately, most governments continue to provide substantial subsidies for fossil fuels, thus imposing further disadvantages on other technologies, including in particular renewable energies.

Complicating matters further, the true cost of electricity production using fossil fuels is not clearly understood by the general public or, in some instance, policymakers themselves. This often results in misleading conclusions due to inappropriate comparisons between end-user tariffs, the cost of subsidised hydrocarbon-based generation and the cost of renewable energy.

The existing price levels therefore cannot support new generation investments, neither by attracting private investors nor by providing domestic utilities with the means to invest on their own. The cost structure of retail energy prices are also not transparent to customers, and do not incentivise responsible customer behaviour, for example with respect to energy efficiency.

Phasing out subsidies, ensuring fair prices that reflect the real cost of electricity products and improving efficient energy use have become imperative to stimulate investment in much needed generation capacity and grids to attain the growth goals of these countries. This challenge is particularly great considering the high population growth and unemployment rates, as well as poverty levels and social equity concerns in these countries. Shifting subsidies away from fossil fuels is important, but the short-term impact of these changes on energy consumers must be carefully managed to avoid political backlash. Low electricity prices as a support means for vulnerable customers are not an adequate response: they incentivise the waste of energy and allow those who are not in need to unnecessarily benefit. Therefore, social targeting is in any policy measure a condition *sine qua non*.

III. Formulate sound and transparent energy policies

EURELECTRIC member companies mention the lack of stimulating investment policies as well as the general lack of transparency on energy strategies and policies as important investment barriers.

In some countries, uncertain policies create an ambiguous investment climate. It is therefore evident that credible policy and maximum market transparency is required to generate private sector interest in this sector, and the lack of supportive, long-term, consistent or stable policy regimes constitutes a big barrier to investment.

Mobilisation of financing requires a holistic energy policy strategy that is tailored to the local context and that combines a sound organisation of the market, supportive regulatory framework with targeted interventions to address market failures. Effective national policy is critical to create the kind of markets that financiers will find attractive.

Investors need this transparency on national energy strategy, the choices made in this context, and the rationale for those choices.

IV. Facilitate technical and political coordination and cooperation on grid investments

Facilitating new regional-scale generation and transmission projects is seen as the key investment priority of the region. The construction and financing of new transmission networks will continue to act as a barrier as generation capacity increases. New large-scale projects rely on sufficient transmission components with well-planned financing of grid extensions and improvements.

Furthermore, it is urgent to develop interconnectors in the region in order to ensure security of supply for interconnected coupled countries and to support economic optimisation. Expanding cross-border trade can indeed be a cost-effective way to increase reliability and affordability, but technical and political barriers persist.

To overcome such barriers, the development of an intense technical and political cooperation is fundamental. Institutions like MEDREG, MEDGRID and MEDTSO are increasingly involved in developing strong institutional partnerships at both regional and international level, promoting effective exchange and leading to further integration of the region's countries. Synergy between these organisations is crucial, notably to encourage the adoption of compatible cross-border network codes.

V. Open market structures, in particular for RES generation projects

Competition should be introduced where possible, notably in power generation, trade, ancillary services and electricity supply, provided that a level playing field is established and that national markets are sufficiently large, or that interconnections exist, giving room to larger regional markets.

Deregulation within national and regional energy markets is important to allow free entry and exit of new players and to create and facilitate competition among providers, in particular for the development of large-scale renewable energy (RES) generation projects.

VI. Design and implement the right financing mechanisms to stimulate exploring the RES potential

Despite the substantial economic potential of renewable energy (RES) across the MENA region, a number of factors currently make such projects economically unviable without targeted government support. Main barriers include:

- Market risks: MENA economies generally experience wider fluctuations of macroeconomic indicators, making their investment climate harder to forecast for investors. This in turn results in higher borrowing costs, shorter loans, and higher equity requirements for finance.
- Technology/Capacity risks: the limited expertise and experience (of the labour force) can lead to misjudgements, decrease anticipated productivity, and unexpectedly increase costs. Relevant knowledge and capacity is often also limited among relevant public administrations.
- Access to finance: High upfront payment and risks associated with RES projects will typically lead to high premiums required by banks. Cost transparency need to be

improved and organisation questions regarding market integration need to be better answered.

Due to the structure of the energy markets in the region and because energy prices, including fuel oil and electricity, are subsided for end-users, there is an identifiable need for well-designed and targeted government investment incentives and support mechanisms in order to develop private investment in RES in the region. A lack of clarity and coherence regarding available opportunities currently undermines private sector participation and competition in most of the countries.

MENA governments should therefore design investment incentives that drive private investment to take advantage of the private sector's financing capacity, to profit from technology transfers, to optimise their oil and gas trades and to benefit from the positive environmental externalities (e.g. a lower carbon footprint).

The most meaningful public finance programmes employ a package of financing mechanisms rather than relying on any single mechanism or fixed set of mechanisms. These packages may include lines of credit to local finance institutions; project debt financing; loan softening programmes; guarantees to mitigate lending risk; grants and contingent grants for project development costs; equity, quasi-equity and venture capital; or carbon finance facilities. The programmes should seek to leverage additional private financing to the largest possible extent, and adopt a portfolio approach that avoids creating path dependency on any specific set of technologies.

VII. Improve education and technological transfer

Too few incentives exist to encourage the private sector to hire and train local staff or to create business linkages with local SMEs. There is a need to shape strategy further by providing dedicated training for key energy decision makers within the MENA countries in order to improve competence and share knowledge and information between EU member states and the region, e.g. on network codes, technical standards, and RES project financing.

VIII. Enhance the EU-MENA Energy Cooperation: extend the Energy Community concept towards the South

The MENA countries stand to benefit greatly from the EU's energy strategy, certainly with the new momentum brought by the Energy Union. Whereas most MENA countries were traditionally relevant to the EU's energy market because of their vast fossil resources, they have recently become increasingly relevant because of their substantial RES potential.

Within the framework of the Energy Union, there is now a clear opportunity for the EU to become more aware of its role and influence in the MENA region and to start thinking about long-term engagement. The European Commission (EC) has already in the past envisaged the concept of a Mediterranean Energy Community by 2020. The EC should continue to develop ideas to open a credible window of opportunity for the integration of Southern Mediterranean energy markets within the EU one.

The main challenge for the EU will be to incentivise its neighbours to strive to adopt EU regulations without being able to rely on a well-developed institutional framework for energy cooperation and without offering them fully-fledged EU membership.

Energy regulation diffusion to other regions has however proved to be successful in the past, for instance with the enlargement of the Energy Community to countries like Ukraine or Moldova. In order to persuade MENA countries to join the Energy Community the institution should however be much more supportive to organising a broad knowledge exchange and having a closer look towards the barriers and weaknesses in implementation of the Treaty rather than focusing too much on the legal enforcement aspects.

The right way forward for the South will most likely be a step-by-step approach that leads to better framework conditions for a possible set-up of a Southern Mediterranean Energy Community in the long run. The set-up of industry and regulatory fora and workshops to enable necessary regulatory and market reforms and grid infrastructure are a priority first step. This could be followed by initiating the design of a centralised control centre to monitor the activities of electricity TSOs in the Mediterranean region. Appropriate and harmonised regulatory frameworks for the development of RES and energy efficiency could be considered as another step, including e.g. the support for RES export projects with the use of the existing cooperation mechanisms. In the medium to long term the further liberalisation of the energy markets could provide MENA countries with the opportunity to join the Energy Community.

EURELECTRIC pursues in all its activities the application of the following sustainable development values:

Economic Development

- Growth, added-value, efficiency

Environmental Leadership

- Commitment, innovation, pro-activeness

Social Responsibility

- Transparency, ethics, accountability

Union of the Electricity Industry - EURELECTRIC aisbl
Boulevard de l'Impératrice, 66 - bte 2
B - 1000 Brussels • Belgium
Tel: + 32 2 515 10 00 • Fax: + 32 2 515 10 10
VAT: BE 0462 679 112 • www.eurelectric.org