

**1<sup>st</sup> Energy Regulation & Investment Conference**  
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**KEYNOTE ADDRESS**

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**President Jean Lemierre**  
*European Bank for Reconstruction and Development*

It is good to be here with you in Budapest this morning. Your initiative is both great and timely. Great because energy is the key issue in the EBRD's countries of operations. It is the main problem in the region, its economy, its social questions, its governance, its corruption, its power. Let us be clear here – what you do is crucial for the region. It is timely, because in the region there are needs. There is sometimes a lack of reform. But there are successes and we recognize one in Hungary. It is good that you are exchanging views to build on these successes.

I am sorry that Chairman Jarai has left. I was going to make a comparison between the Chairman of the Central Bank and the regulators in energy. They share the same characteristics, but please don't listen too much to him and I'll tell you why. The main or common elements are predictability, stability, fairness. But, there is a difference. The Central Bank has to fight against inflation and you should accept tariff increases, and that is a big difference. So, let us try to build a little on this.

EBRD is highly involved in the energy sector, and in a few minutes Tony Marsh will explain to you better than I can what he does with his team. We have investors and money everywhere. We are working with most of you, with all of you I hope, and we are committed to the region. We are committed to the question of energy.

Why is it important? I have heard many nice words, but the situation is not good. I will give one example: energy intensity. What is the situation in EBRD's countries of operations? Energy intensity is four times higher in Central Europe and the Baltic states than in Western Europe. It is nine times higher in the Southeast of Europe. It is thirteen times higher in the CIS countries. I will stop there. It demonstrates a huge problem.

What does it mean? It means a waste of resources. It means a huge problem of debt for many of your countries, when these countries are dependent on imports of energy. As a former Chairman of the Paris Club, I can tell you that I know how difficult it is for most of you. It has also created an awful situation as far as pollution is concerned. So, the situation is very serious.

It has mainly two causes from our point of view. The first is that power sector production is not at the normal level of quality. Investment has been low and there is a lot to be done there. But something also has to be done on the consumption side: it is mainly the heavy, old industries which consume too much electricity. There is a great need for restructuring all these activities to be more efficient.

What solutions do we see? There are primarily two main paths towards solutions. The first is the reform of prices. This is the reason why I said there is a need everywhere in the region for

tariff increases and for improvement in cash collection. In all the countries of operations of the Bank the tariffs are too low and provide very limited incentive to increase energy efficiency. Cash collection in the CIS countries is around 50% on average, but you know better than I do that the situation is not good in certain countries. This situation – low prices, low cash collection, a historical tradition of cheap energy for households and for industry – is certainly not a good incentive for investment progress. Higher prices would certainly increase the efficiency of consumption, the efficiency of distribution, and, of course, the efficiency of production.

I would like to address this message to the regulators and to the governments: there are two conditions to increasing tariffs. It is easy to say this, but it is much more complex in reality. The tariff increase must go in tandem with two reforms. The first is social safety nets to protect low-income groups. We have a clear vision of this, if you do not put social safety nets in place at the same time, there will be a backlash. The worst thing for the region would be to have huge political problems because of tariff increases. That is the first point. One discussion you could have at this forum would be about the best ways in which to put in place these social safety nets, because they are valuable solutions. A discussion among you would certainly be very useful for the governments. What is the best solution? It is difficult. Can I say that this is true not only for energy, but also for water and waste-water. It is true for many utilities. But, I am quite sure that you are in the forefront of the policy, the approach, and maybe the innovation.

The second reform, which must be implemented at the same time by the governments, is the restructuring of the old industries to save energy. It is useless to increase the tariff rates and yet to have old-type cement plants using a lot of electricity. It is useless to go on working with aluminum plants consuming a lot of electricity. This is a key issue. I think what you have to work on, if I may say so, is a very comprehensive approach. Better pricing, meaning tariff increases and improvement of cash collection, social safety nets and the restructuring of the old industries. This is the best solution to move forward and make progress.

The second main set of reforms, which must be put in place, is the reform of the regulatory system. This is crucial to support reform of electricity prices. Let us be clear. You need to be strong. You need to be powerful. You need to be supported by the governments, your regulators, and we wish you to be very strong. This is the key necessity if we want to improve the situation in the energy sector. But, you must also implement the rules you have. You must negotiate with the investors in a transparent, predictable way. I travel a lot in the region and I know many countries and I know some of you. I spend a lot of time in policy dialogue between the investors and the governments and the regulators, and that is not good. It should not happen. I should not have to do this. The dialogue should be very good among you in a transparent way. It means the necessity to de-politicize tariff reforms and regulation and this is a huge reform. I can understand it is difficult for many reasons, but it is crucial.

We might think, and this is the commitment of the EBRD, that the private sector would invest more, because, at the end of the day, what is needed in the region in the energy sector is more investment, a lot of investment. Money is needed to improve the situation and produce electricity at a cheaper price, in a safer and permanent way, which is not currently the case.

I want to convey a very simple message, to make it short, to the governments: put in place regulators, give them independence and trust them. I know it is quite easy to say this in a speech and it is difficult to implement. But do it. This represents the credibility of the whole reform process. For the regulators, be strong. Do not accept interference. I know this is not easy either. It is difficult. It is perhaps not tradition. It takes time to build a system. But, also be simple. I am sometimes amazed by the complexity of some discussions when, at the end of the day, the reality is to accept the small increase. So, make it simple. Do not worry about too many details. I do not believe in too many technical discussions on these questions. Be simple, but mainly be stable, be predictable - that is the key issue.

There is also a message for the investors and you are the ones with whom we work most. You have to accept two things. The first is to be transparent and accountable. The price of fairness from the regulator is your transparency. Use accounting standards that are respected throughout the world: use good accounting companies. This is a problem that has been mentioned. It is a serious question for the regulators. Be transparent. Be clear. Respect the best, corporate governance rules. This is crucial.

I would like to give you a second piece of advice. Pay a lot of attention to the social dimension of your job. I would like to mention here the success of one country: Moldova. Union Fenosa is doing a tremendously good job in a difficult country where the situation was not good. Why? Mainly because when I went to Moldova, people said they are good because they pay attention to the social dimension of their job. This is the key link between you, the governments and the regulators. If progress is visible, the population will accept tariff increases. This type of approach is certainly the most important partnership we can create. There is no other solution than to show that it is a good circle that it works well. The other message would be to you businessmen. In the region there are needs and very good opportunities for investment and you should venture there. My commitment to you is that we are ready to go with you to share part of your risk. If you come and see us, see Tony Marsh, we will be very happy to take part of your risk. In the present world, there are not so many risk-takers or risk-sharers. We are one of them and it is our duty to work with you, work with the governments, and work with the regulators to take part of the risk and improve the situation.

In this conference today you are addressing what we believe is the main challenge in the region. The fact that this conference is taking place is a crucial element for us. It means there is dialogue. Dialogue is paramount. A good, mutual understanding is crucial for everybody.

I will add one point. Today we may be talking about this aspect, but what I propose for your next meeting is to talk about another dimension of the issue and that is the regional dimension. *I'm quite sure the region will enter quite soon, or part of the region, in the regional approach as far as energy is concerned.* I think it will bring more competition; it will perhaps bring hope to some countries. I would simply like to say that this would probably become the main element of movement in the future. Electricity is the key issue in all countries. Politics, once more, is a key element of power, the key element in society, the key element in the social approach, and these are international dimensions. It has been said that it is true for the EU, but it will also be essential in the other countries. More competition in other countries of the region will, I hope, bring success, thanks to your work today and your next meetings.