RISK AREAS AND INDICATORS FOR EIRA

EIRA evaluates specific risks affecting energy investment that can be mitigated through adjustments to policy, legal and regulatory frameworks. The performance of countries against the EIRA risk areas is evaluated through four indicators. The indicators are constructed to reward countries for sound regulation and efficient processes. They capture the ability to cope with the risks through various positive measures such as the creation of predictable policy objectives, transparent decision-making, the establishment of strong public institutions, development of competent market oversight mechanisms, and the successful resolution of disputes with foreign investors.

What are the risks assessed by EIRA?

EIRA analyses the following risk areas:

Unpredictable policy and regulatory change
Governments reserve the right to adopt measures that are necessary for pursuing legitimate public policy objectives. Nevertheless, unsystematic and arbitrary modifications can detrimentally affect the interests of foreign investors. They can lead to increased or stranded costs for operating a business, reduced attractiveness for investment, and an overall distorted competitive landscape. Foreign investors may reconsider investing in the country or relocate the investment. It follows that in exercising their right to regulate, governments must make investors aware of the conditions and nature of policy changes.

Discrimination between domestic and foreign investors
Foreign investors need clarity on the extent to which markets are competitive and whether they offer a level playing field. While discrimination can take various forms, between energy resources, technologies and types of investors, EIRA focuses on discrimination between domestic and foreign investors. This includes the likelihood of an unfair advantage to local investors, as recipients of rights and privileges, to the exclusion of foreign investors. Discrimination may also occur in the form of ‘protectionist’ practices intended to restrain trade and give rise to foregone investment gains.

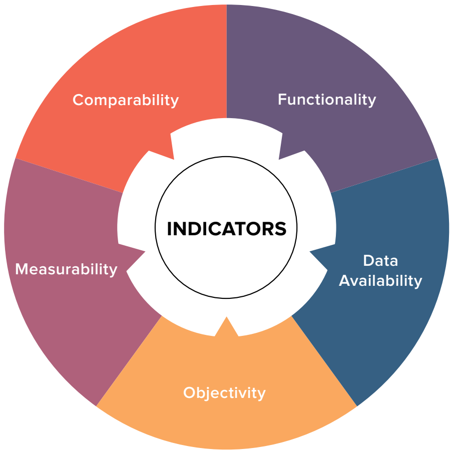
Breach of State obligations
Disputes brought by investors against a State can disrupt the relations between the two parties and even damage the overall investment climate. Investors must have confidence that they will have recourse to mechanisms for dispute resolution and the enforcement of rights if governments default on their obligations. Such obligations include protection against discrimination, expropriation and nationalisation, breach of investment treaties, and limited access to alternative dispute settlement avenues.

How are the EIRA indicators selected?

The indicators have been constructed from a wide range of variables. They bear direct relevance to a government's overarching objective of creating a secure, favourable and transparent investment environment.

Five criteria are applied to determine the appropriate indicators:

Figure I.1 – Criteria for selection of indicators



Functionality/Actionability – Indicators are 'reform-oriented'. They reflect best practices through which countries can manage the risks. They capture aspects of policy-making and regulation that are under the control of governments.

Data availability – Data for indicators is available from sources that are reputable and reliable. Indicators are based on data that is relevant, readily accessible and easy to collect.

Measurability – Indicators provide a quantifiable assessment. They are robust and unaffected by minor changes in the method used for their construction.

Comparability – Indicators allow comparability across (1) countries; (2) energy sub-sectors; and (3) the energy value chain. Additionally, they are consistent and comparable over time.

Objectivity – Indicators reflect an accurate overview of the policy, regulatory and legal reality in the assessed countries.

What are the EIRA indicators?

Based on the above criteria the indicators selected are:

- Foresight of policy and regulatory change
- Management of decision-making processes
- Regulatory environment and investment conditions
- Rule of law (compliance with national and international obligations)

The indicators are cross-cutting and apply to more than one risk. Each indicator consists of two sub-indicators. They measure the ability of governments to identify whether the assessed risks exist and the extent to which they can be mitigated. The indicators reward countries for taking positive measures that manage and limit arbitrary or discriminatory policy changes which could result in a breach of State obligations. Such measures include designing and setting long-term policy objectives and goals, ensuring transparency in decision-making, granting equal treatment to foreign and domestic investors, and effectively managing disputes with foreign investors.

Table I.1 – Correlation between EIRA risk areas and indicators

RISK AREAS	INDICATORS			
	Foresight of policy and regulatory change	Management of decision-making processes	Regulatory environment and investment conditions	Rule of law
Unpredictable policy and regulatory change	✓	✓		✓
Discrimination between domestic and foreign investors		✓	✓	✓
Breach of State obligations				✓

INDICATOR 1

Foresight of policy and regulatory change

National energy priorities and regulatory frameworks evolve in response to changing circumstances. Meeting new objectives may result in policy revisions, and governments must be sensitive to the impact of such revisions on long-term investments. Ensuring stable conditions is a major challenge as the global energy transition is proving to be a highly dynamic process. Policy and investment patterns are likely to evolve as countries seek to decarbonise their energy sectors under the Paris Agreement. Managing this change is crucial, so governments must communicate any adjustments to their energy policy objectives and effectively plan and implement the means to pursue them. Investors can then better manage risk, modify investment portfolios and cope with the policy changes.

SUB-INDICATOR:

COMMUNICATION OF VISION AND POLICIES

This sub-indicator captures the commitment of governments to convey the vision of their energy sector. It also looks into the approach and principles that will guide governmental decisions in this respect.

Risk management requires a view on the future. This forward-looking vision is typically enshrined in strategy documents of governments, which inform investors about the energy goals to be achieved and the timeframes for their achievement. As countries transition to sustainable energy systems, new demands are placed upon regulatory frameworks and existing decision-making structures. Understanding the energy landscape and how it can evolve is a central element of investment planning. Hence, communicating any intended changes in a clear and timely manner contributes to bolstering investor confidence and averting risk. Moreover, the establishment of milestones or short- and medium-term goals indicates to investors the pace of change and the progress made towards the final goals and targeted outcomes.

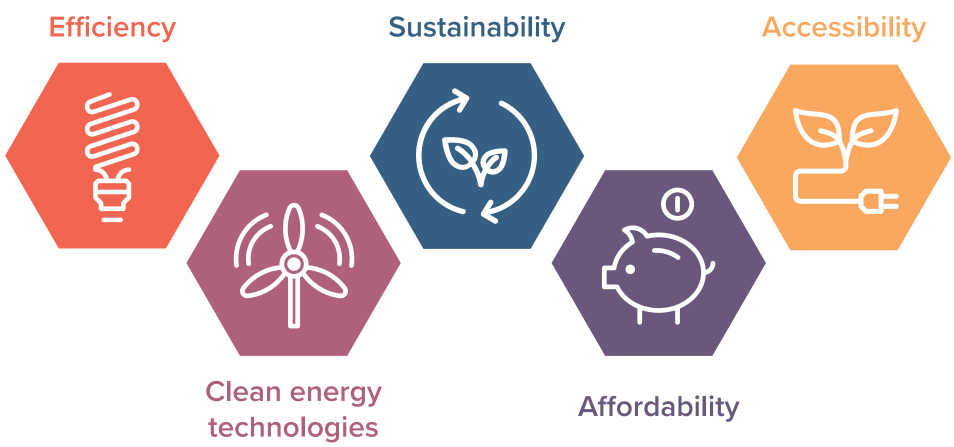
SUB-INDICATOR:

ROBUSTNESS OF POLICY GOALS AND COMMITMENTS

Good governance and the creation of effective monitoring mechanisms indicate the determination of governments to attain their policy goals. Conversely, a fragmented or weakly implemented monitoring and evaluation framework can significantly reduce the ability of policy makers and investors to track if real progress has been made on the goals.

This sub-indicator focuses on monitoring and evaluating the implementation of the energy goals. Monitoring provides an opportunity to assess the progress towards meeting energy objectives and identifying potential gaps. Furthermore, it allows governments to ensure that policies are periodically updated and amended when necessary. In this context, the establishment of an independent and competent authority with the appropriate monitoring and reporting mechanisms is critical. It gives investors the confidence that policies will be evaluated and improved to achieve the desired outcomes and will not be subject to arbitrary modifications.

Figure I.2 – Energy priorities under the UN Sustainable Development Goal 7



INDICATOR 2
Management of decision-making processes

The second indicator addresses the importance of coordinated and transparent policies in eliminating perceived or actual opacity of government initiatives and the exclusion of investors from the planning and decision-making phases. To ensure structured and simplified decision-making processes the role and responsibilities of different governmental levels must be defined. It is also essential that investors are well informed and consulted whenever governments intend to revise laws or regulations. Stakeholder engagement allows foreign investors to participate in decision-making processes actively and take well-informed and timely decisions.

SUB-INDICATOR:
INSTITUTIONAL GOVERNANCE

Formulating investment and energy policies may involve several levels of government and ministries. Provinces, municipalities as well as regional and local authorities may also participate in framing policies. This can make the process relatively complicated and result in the risk of overlapping decisions. Unless well managed, complex institutional governance may lead to the adoption of sub-optimal choices or conflicting laws and policies.

This sub-indicator measures how well governments coordinate policy-making. While the degree of centralisation in each country may differ significantly, one central body should ultimately be responsible for coordinating across different levels of government and reconciling the diverging perspectives of public agencies. Effective intra-governmental and inter-ministerial management in undertaking policy design and implementation is, therefore, an essential precondition for minimising unpredictability and maintaining an investment-friendly climate.

Figure I.3 – Key aspects of effective decision-making process

SUB-INDICATOR:
TRANSPARENCY

Policy and regulatory changes are always risky for investors. However, if they are systematised and transparent, investors can adapt to them better. Transparency is beneficial to all types of investors, but it is particularly crucial for foreign investors who have to cope with regulatory systems and administrative frameworks that are different from their own. This sub-indicator gauges the openness demonstrated by governments in designing and implementing their laws and policies.

EIRA understands transparency as first, effective communication of information on national laws, regulations and practices that may materially affect investments; and second, prior notification and consultation of regulatory changes that are of interest to investors.

Governments can enhance the quality and predictability of their regulatory framework by reviewing and publishing administrative decisions, codifying legislation, disseminating regulatory materials, and developing registers of existing and proposed regulation. These core transparency measures help to ensure that investors are aware of policies affecting them. Prior consultation on investment and energy-related governmental actions can provide investors with more foreseeable conditions in the host countries. For instance, it may reveal indirect discrimination caused by secondary measures that deviate from the enabling legislation. Moreover, affording interested parties the right to comment may lead legislators and regulatory authorities to reflect carefully before modifying existing laws and consider alternatives.

INDICATOR 3
Regulatory environment and investment conditions

This indicator evaluates the independence exercised by energy regulators in their decision-making and other functions. Independence from national governments and the industry guarantees neutrality and helps to avoid situations where regulatory decisions are constantly revised to the detriment of some market actors and investors. It further examines the extent of restrictions faced by foreign investors in the energy sector. Despite the increasing realisation that international capital flows are crucial for the development of the energy sector, persisting restrictions act as serious deterrents for foreign investors. Key restrictions include screening and local content requirements, as well as limitations on currency and investment-related capital transfer, which tilt the playing field in favour of domestic investors.

SUB-INDICATOR:
REGULATORY EFFECTIVENESS

Market monitoring by a dedicated and expert institution minimises the risk of biased decision-making, discriminatory market rules and anti-competitive behaviour. Political distance gives the regulatory authority credibility because it limits governmental influence and provides assurance that political events will not interfere with regulatory functions.

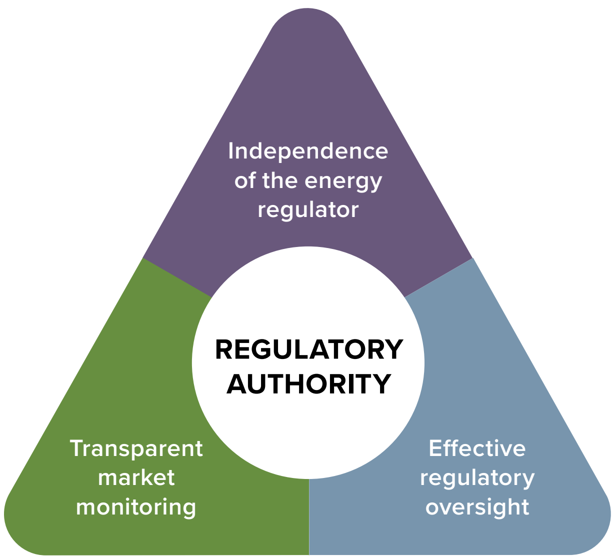
This sub-indicator examines the energy regulator's autonomy based on various parameters including whether its duties and powers are embedded in legislation and how they are defined in relation to ministries and government executives. It also scrutinises the regulator's financial autonomy, its accountability as well as the transparency exercised in the selection of its staff.

SUB-INDICATOR:
RESTRICTIONS ON FOREIGN DIRECT INVESTMENT

Overt policy and regulatory measures that discriminate between domestic and foreign firms can have a restrictive effect on inward investment flows. They can obstruct foreign investments or make the cost of operation unbearable. Some of the typical restrictive measures foreign investors may face are mandatory screening and approval procedures, regional investment restrictions, and operational controls.

This sub-indicator assesses the countries' commitment not to discriminate in the treatment afforded to domestic and foreign investors. It evaluates whether they receive equal treatment in the application of laws and regulations. Particular attention is given to the national treatment of foreign investment including sectoral restrictions, limits on the transfer of profit and repatriation of capital abroad, and onerous local content requirements.

Figure I.4 – Regulatory environment and investment conditions



INDICATOR 4
Rule of law (compliance with national and international obligations)

EIRA relies on the 'rule of law' definition presented in the UN Report "The rule of law and transitional justice in conflict and post-conflict societies"[1]. It focuses on three aspects of this definition. First, fair and effective implementation of national laws and international commitments arising from treaties and international agreements; second, settlement of investor-State disputes promptly and according to due process; and third, respect for the property rights of foreign investors. Peace, security and human rights are outside the purview of EIRA.

SUB-INDICATOR:
MANAGEMENT AND SETTLEMENT OF INVESTOR-STATE DISPUTES

This sub-indicator measures the efficiency of case-management and settlement procedures within the assessed countries. Foreign investors place a premium on adherence by the host countries of their obligations to: provide accessible, clear and predictable legislation, avoid retrospective changes to legal acts, ensure equality before the law, resolve disputes without undue cost or delay, and comply with their commitments under international, as well as national laws.

Well-organised judicial procedures help to foster investor-State trust. Effective enforcement of foreign judgments and awards reduces uncertainty because investors are assured that the domestic courts will safeguard their rights. Similarly, the existence of appeal mechanisms and domestic dispute mitigation instruments, such as an investment ombudsman and mediation, provide additional avenues for resolving conflicts between investors and States. Beyond the national legal system, governments must provide an extra layer of protection to investors by granting them recourse to dispute-settlement mechanisms under international law. They may give foreign investors this benefit either through BITs or on a case-by-case basis.

SUB-INDICATOR:
RESPECT FOR PROPERTY RIGHTS

This sub-indicator assesses the risk to investors of losing ownership or control due to governmental actions or restrictions. These actions can also lead to the additional risk of discrimination when foreign investors in particular suffer such loss.

Under this sub-indicator, the term 'investment' refers to tangible and intangible assets, including intellectual property rights. It does not delve into the forms of expropriation. Instead, it focuses on whether expropriation, nationalisation or confiscation (or any action tantamount to these) was undertaken for a legitimate public purpose, following the due process of law, in a non-discriminatory manner and with adequate compensation.

Some steps governments may take to reduce the risk of perceived arbitrariness are first, defining expropriation in their domestic laws; second, describing the process for the determination of compensation; and third, setting the timeframe for the payment of compensation. This gives increased security to foreign investors operating under the existing BITs and also protects investors that are not covered under these treaties. In turn, investors can also assess whether the host country's laws, mechanisms and guarantees are in line with international practice and investment-related agreements. This adds to the reliability and enforceability of property rights against arbitrary expropriation. By determining the circumstances under which expropriation may take place, foreign investors can take measures to fortify their investments.

Figure I.5 – Rule of law elements covered by EIRA

1 EIRA interprets 'rule of law' as "a principle of governance in which all persons, institutions and entities, public and private, including the State itself, are accountable to laws that are publicly promulgated, equally enforced and independently adjudicated, and which are consistent with international human rights norms and standards. It requires, as well, measures to ensure adherence to the principles of supremacy of law, equality before the law, accountability to the law, fairness in the application of law, separation of powers, participation in decision-making, legal certainty, avoidance of arbitrariness and procedural and legal transparency." United Nations, Report of the Secretary-General, *The rule of law and transitional justice in conflict and post-conflict societies (2004). UN Member States reaffirmed their commitment to uphold "rule of law" in the United Nations, Declaration of the High-level Meeting of the UN General Assembly on the Rule of Law at the National and International Levels,* A/RES/67/1 (30 November 2012).

EIRA METHODOLOGY

EIRA assesses three types of risk to energy investment. It applies four indicators to (1) identify the actions needed to address these risks and (2) highlight the corrective measures countries may take to mitigate them.

The risks are evaluated by examining whether necessary laws, policies and actions have been adopted by countries. However, legislation and policy measures will have maximum impact when they are enforced. EIRA 2019 recognises this and tries to give a clearer picture regarding the application of laws and policies. This year, the country profiles have been structured to better reflect the implementation of the existing policy framework and highlight the progress made by countries in translating their commitments to actions.

No variations have been made to the methodology since last year. The indicators are based on a questionnaire developed by the ECS over a period of two years. The questionnaire is designed to ensure it is comprehensible to respondents and that information obtained is easily verifiable. It allows comparability across energy sub-sectors and captures trends over time. Most questions are binary, requiring simple "Yes" or "No" answers. Granular options are provided in some cases to obtain more detailed information. Moreover, respondents have the opportunity to offer additional remarks and brief descriptions of policy programmes (these questions are not scored).

How are the respondents for EIRA selected?

The EIRA questionnaire is provided to the governments of the participating countries. To counter the perception of self-assessment and secure an objective viewpoint, it was also sent to selected external parties in the assessed countries.

The unit of analysis for EIRA is a country. The policies taken into consideration are those framed and implemented at the national level. In federal arrangements, the central government is designated as a single point of contact responsible for collecting and processing inputs from relevant ministries/departments at State and municipal level.

External parties are chosen from a pool of experts comprising local and international law firms, legal practitioners, business councils, accounting and consulting firms, think-tanks, energy associations, chambers of commerce, international institutions and non-governmental organisations operating in the assessed countries. In 2019, over 550 external parties were contacted of which 21 per cent were selected based on their expertise, availability, and willingness to participate. Extensive research was conducted before the final decision.

The main parameters for selecting the external parties are:

Expertise in the energy sector: Active involvement in different stages of energy projects, and experience of providing consulting services in multiple energy sub-sectors and on regulatory issues.

Diversity of clients and neutrality: Vast experience working with governmental entities as well as private investors. This ensures the external party has a holistic understanding of issues in the energy sector and contributes to a more balanced approach.

Reputation: Parties with extensive global reach or local partner groups. For law firms, international guides identifying leading providers of legal services (local and global) in each country are consulted.

What is the data collection and validation process for EIRA?

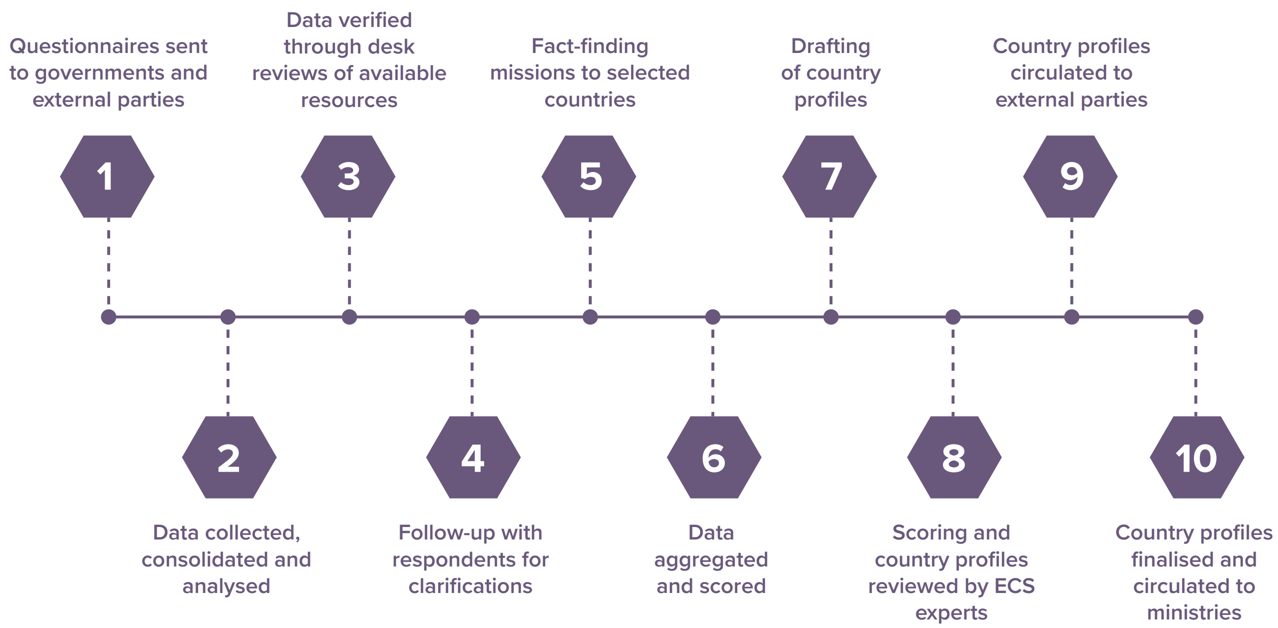
Data for EIRA is collected in a standardised manner. For the 2019 edition, responses from the participating countries and external parties were collected over a period of five months. The respondents provided copies of the source documentation and translations (if required) that supported their responses. The data provided was accepted only to the extent that it was premised on original laws, regulations, national plans and strategies. Legislative initiatives and regulatory reforms not legally in force on 1 April 2019 were not taken into consideration.

Upon receipt of the questionnaires, the ECS in-house investment, legal, regulatory and energy efficiency experts engaged in an extensive process of validating information provided during the survey. In particular, it was confirmed that each question was correctly understood by the respondents and that the documentation submitted supported the response given. In the absence of documents, or in the case of conflicting answers, clarifications were sought through correspondence and phone interviews with government officials and external parties. Answers obtained were once again reviewed and cross-checked for consistency with known elements of each country's investment policies and energy sector.

Efforts were made to address the issue of low data availability in certain countries. As an exceptional case, due to the lack of external parties, the country profile of Burkina Faso was based on the information provided by the Government and the desk research conducted by the ECS in-house experts. In selected countries, fact-finding missions were also undertaken to obtain hands-on information. The purpose was to gain insight into their regulatory and investment environment as well as obtain the views of different stakeholders in the energy sector.

Overall, the process of data collection and validation lasted eight months, from December 2018 to July 2019.

Figure I.6 – Data collection and validation process



How are risks assessed in EIRA?

EIRA relies on a blend of quantitative and qualitative analysis. The quantitative analysis is performed using a scoring system that conveys the performance of the countries on the indicators. The more complex dynamics of the assessment are represented through qualitative country profiles that identify areas for improvement using narrative and visuals.

Scoring system

All indicators carry equal weight. The total for each indicator is the average of its component sub-indicators. Each sub-indicator is similarly calculated through a set of questions. The questions are scored between 0 and 100 and are equally weighted. The highest achievable score for each question is 100. All the scores have been rounded off for the risk areas and the indicators. The overall performance across each indicator is defined as the average of first, the score received in the government questionnaire; and second, the combined average of the external party scores.

Figure I.7 – Scoring an indicator for individual respondents

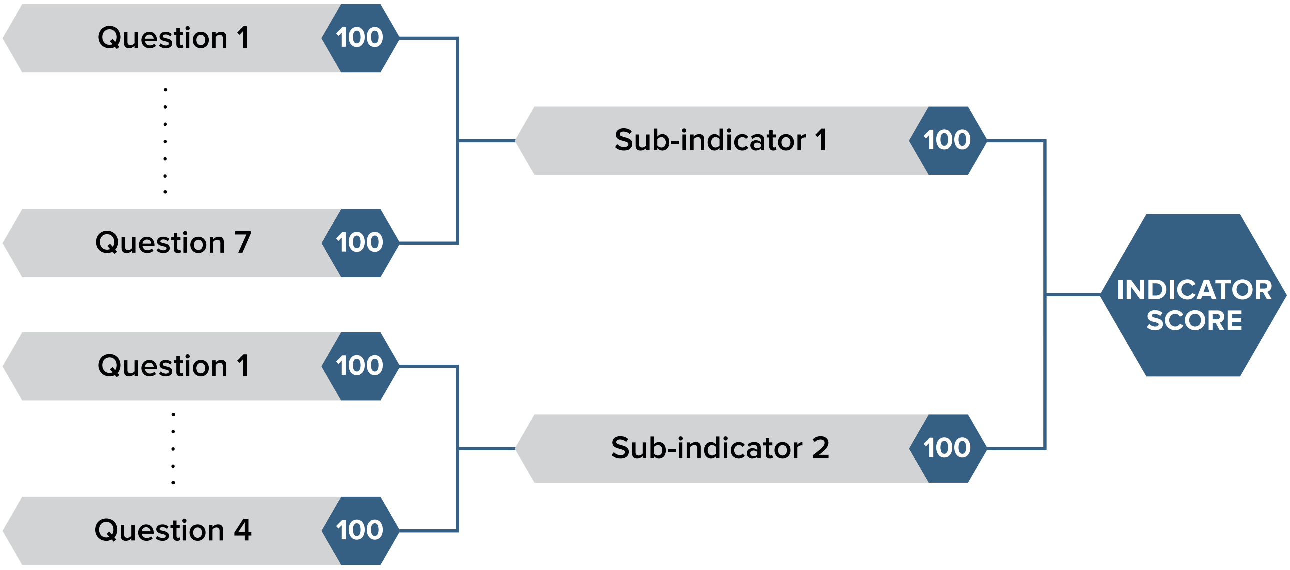
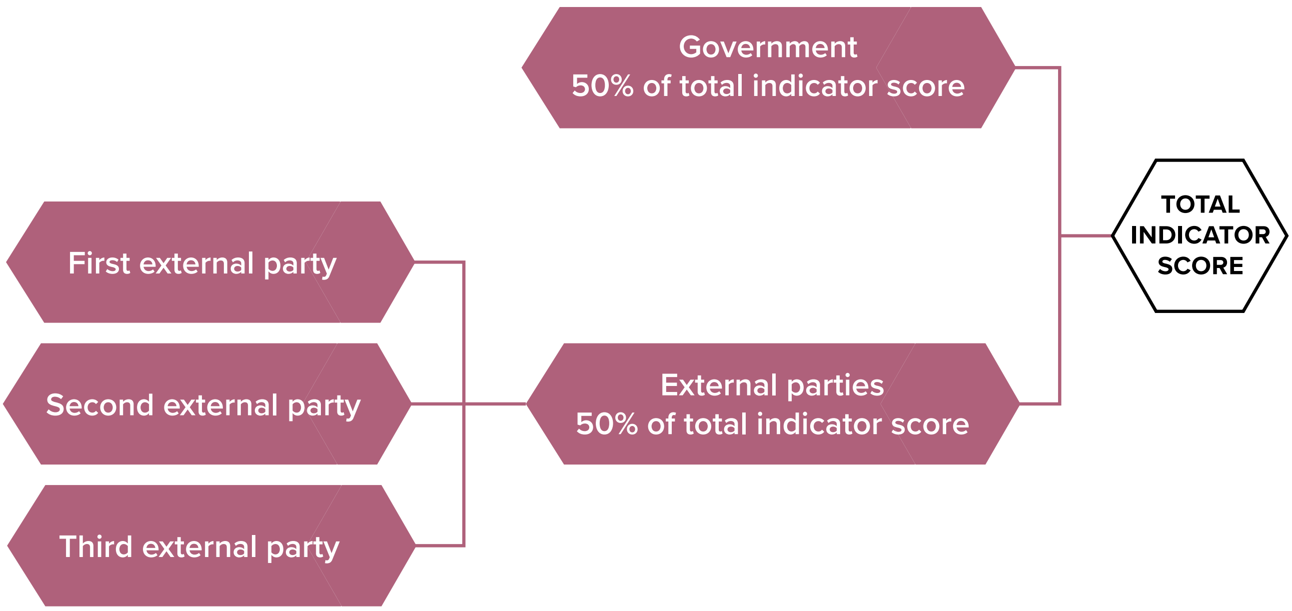
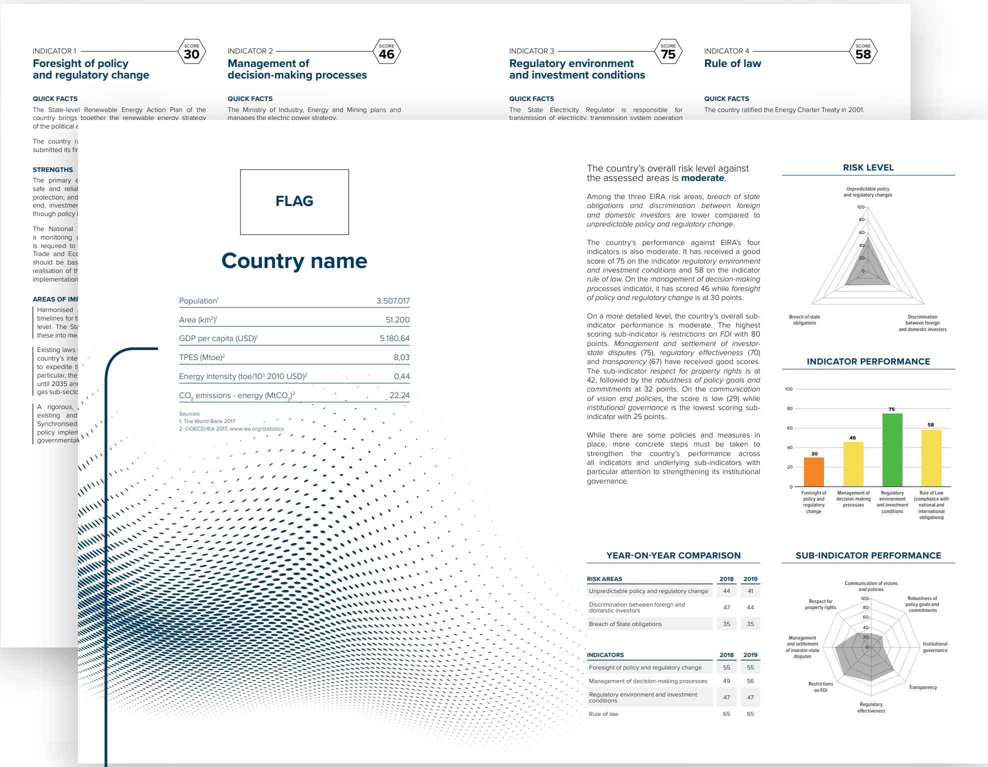


Figure I.8 – Total score for an indicator



Country profile outline

The qualitative assessment for each country is visualised through a four-page profile. The initial two pages provide an overview of the country. They feature a table of the country's key metrics and three charts. The metrics include demographic, economic and energy information and give a background to the country's profile. The first chart illustrates the risk level across the assessed areas. It is followed by a bar chart that shows the performance of the countries on each of the four indicators. A 5-colour coding approach is used for this purpose. Dark green represents the highest band of scores while red represents the lowest. The third chart breaks down the country's performance across the sub-indicators, where 0 denotes the weakest and 100 the strongest performance. The remaining pages of the profile offer a detailed analysis of the country's performance on each indicator. They present the overall score for each indicator and summarise the key strengths and areas for improvement. Profiles of the recurrent countries now have a table that reflects the change in their performance vis-a-vis 2018 on (1) the risk areas and (2) the indicators.



KEY METRICS

Population and surface area: Data refers to year 2017. *The World Bank 2017, World Development Indicators, World Bank national accounts data and OECD National Accounts data files, https://data.worldbank.org/ (accessed on 10 July 2019)**

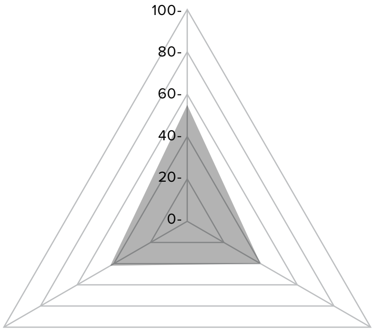
GDP per capita (current US$): Data refers to year 2017. *The World Bank 2017, World Development Indicators, World Bank national accounts data and OECD National Accounts data files, https://data.worldbank.org/ (accessed on 10 July 2019)**

Total primary energy supply (TPES): TPES represents inland demand only and, except for world energy demand, excludes international marine and aviation bunkers. Data refers to year 2016. *OECD/IEA 2018, www.iea.org/statistics**

Energy Intensity: This is a measure of total primary energy use per unit of gross domestic product. Data refers to year 2016. *OECD/IEA 2018, www.iea.org/statistics**

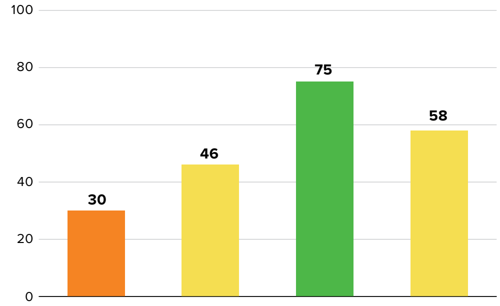
CO_2 emissions from fuel combustion: Data refers to year 2016. *OECD/IEA 2018, www.iea.org/statistics**

*N/A means data is not available for this metric



RISK LEVEL

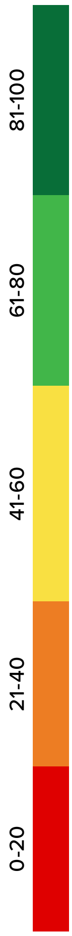
The risk level is displayed by the grey triangle. Each axis represents a risk area. The smaller the size of the grey triangle, the lower the level of risk.



INDICATOR PERFORMANCE

The indicators affect the risk areas differently. For example, rule of law has the highest impact since it influences all three risk areas. For details on the correlation between the indicators and the risk areas, see Table I.1 on page 9.

The bars are colour-coded. Each colour corresponds to a performance level.



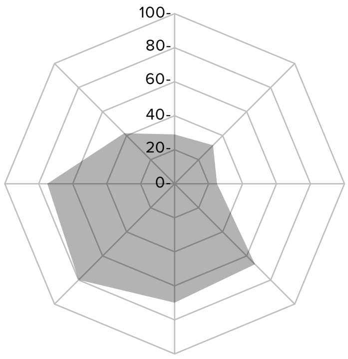
VERY GOOD
The performance against the assessed indicators is very good and the risk level is very low. The country provides attractive conditions for investors and is working in the right direction.

GOOD
The performance against the assessed indicators is good and the risk level is low. While the country has relevant policies and measures in place, there is some potential for improvement.

MODERATE
The performance against the assessed indicators is moderate and the risk level is moderate. There are some policies and measures in place but more concrete steps must be taken to further strengthen the performance.

LOW
The performance against the assessed indicators is low and the risk level is high. Considerable steps need to be taken to improve the performance.

VERY LOW
The performance against the assessed indicators is very low and the risk level is very high. Significant and immediate steps need to be taken to improve the performance.



SUB-INDICATOR PERFORMANCE

Each axis represents a sub-indicator. The larger the size of the grey area, the better the country's performance.

INDICATOR AND SUB-INDICATOR CORRELATION

Indicator 1
1. Communication of vision and policies
2. Robustness of policy goals and commitments

Indicator 2
1. Institutional governance
2. Transparency

Indicator 3
1. Regulatory effectiveness
2. Restrictions on FDI

Indicator 4
1. Management and settlement of investor-State disputes
2. Respect for property rights