Investment in development: Attracting and managing international finance in developing countries

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Introduction

Good afternoon and thank you for the invitation to take part in this discussion.

The Global Leadership Foundation represents a unique body of collective experience and fulfils a valuable role.

As President Kennedy said, “Leadership and learning are indispensable to each other” - and the Foundation brings the two together by enabling those who now lead to learn from those who have led before.

It is an honour for BP to be invited to join this conversation as a representative of the private sector.

We believe that companies need to be involved in this debate.

Private foreign direct investment – FDI - into developing countries has risen rapidly over recent decades while overseas development assistance from the public sector has slowed.

In 1990, aid to developing countries from major OECD donors stood at $80 billion, more than double the level of FDI at $35 billion. But by 2012, FDI had grown 20-fold to reach over $700 billion, while aid had only grown around 50% to around $125 billion - with falls in recent years.

This is a function of many factors including the relentless move towards globalisation in the past few decades.

BP – for example - has always been an international investor – our origins were in modern day Iran – but we are now a truly global company, working in 80 countries and five continents.

I will speak from our experiences and I will divide my remarks into three areas:

First – corporate principles - what are the principles which apply when companies contemplate investments around the world?

Second – country criteria – what encourages a company such as BP to invest in a particular country?

And third – and most important - continuing partnerships - what drives ongoing investment in a country?

I will conclude with what these questions mean in terms of priorities for policy-makers.

Corporate principles

To begin with, some principles about private sector investment as a source of finance.

The role of the company

The first is about the role of the private sector company vis-à-vis public sector actors.

A private sector company is not a state. It is not a state within a state. It is not a quasi-state. It is a private sector company.

What does that mean? At a basic level it means we do not take sides in politics – there is a clear red line.

Our investments are directed towards creating quality products for customers, enduring benefits for society and sustainable value for our shareholders. Our investments can deliver major benefits if the country and the company align their interests effectively. And progressive companies will play a proactive role in trying to reach such an alignment.

If there is a high degree of alignment, business investment becomes an engine of economic activity which generates benefits for the company, the country, and its people.

Last year for example, BP paid around $14 billion in taxes and a similar amount in wages. And we spent hundreds of millions more in operational costs, much of which went to contractor and supplier companies. In the US alone we spent $25 billion with 15,000 suppliers and supported an estimated quarter of a million jobs.

Capital discipline

A second principle is that there is now intense internal competition for capital within companies.

In the global economy, we have seen a period of economic change that pivoted around the 2008 credit crunch. That shock ended an age of expansion and ushered in an age of austerity. These two trends are now synthesising into a new age of discipline – continued expansion, but tightly controlled expansion.

In our industry, capital investment by the so-called supermajors more than doubled from $60bn a year to around $130bn between 2005 and 2012.

That wave is now over and we have entered into our own age of discipline.

Investors are now looking to prudently manage investments within a disciplined capital framework in order to convert that investment into strong cash flow..

Meanwhile, our growing capability and new technology have helped us open up many new options for investment. Shale gas in the US is the obvious example, but there are also new opportunities in deep water, heavy oil, tight gas and tight oil around the world – as well as shale plays beyond the US. BP alone made seven potentially commercial discoveries last year.

In short, this means we have more opportunities than our limited capital envelopes can fund.

There is strong competition for the corporate dollar.

The role of energy

However, once companies have decided where to invest, those investments can foster development and enable prosperity. Our fundamental purpose is to provide the energy that the world needs for development - to help bring people out of energy poverty and into economic freedom.

For all its challenges, energy drives development – it means power for small businesses, lighting for schools, mobility for workers, refrigeration for medicines and a host of other benefits.

I believe that prosperity, in part driven by affordable energy, is the rightful destiny of every country.

Therefore, we actively want our investment to benefit multiple stakeholders – to be not only an investment in oil, or an investment in gas, but an investment in development.

Country Criteria

Let me now turn to the criteria that we take into account when contemplating an investment in a particular country.

At its root, it is very simple. We look for two things: the right resources below the ground and the right conditions above it.

'Above ground' conditions

The resources exist below the ground in many locations. The factors that usually make the difference are above it.

Consider the fact that abundant shale resources exist in Asia, Russia, Europe, Central and South America. Yet the only place where production has really taken off has been North America.

Why?

It has been a classic case of the right conditions above the ground – open markets supported by stable and supportive tax regimes and mineral rights along with public-private collaboration in research that accelerated development of the technologies of directional drilling and hydraulic fracturing. It is an environment where enterprise, talent and innovation flourish.

These conditions have turned conventional wisdom upside down.

For decades, the US was labelled as being addicted to imported energy. Today we are projecting that North America will be self-sufficient in energy by 2030.

And it is interesting to see that such conditions can be replicated in very different settings. Oman, to take one example, has chosen to open its tight gas resources to foreign investment and has enabled favourable “above ground” conditions. The result has been that we are about to begin a massive project, with 300 wells, which will boost the country’s gas supply by around a third, applying the innovation and expertise developed in the US.

Every country presents its own unique profile of risk and reward. What we look for is a willingness on the part of the country to create a symmetry of risk and reward. That means neither party bears a disproportionately high share of the risk - or enjoys a disproportionately low share of the reward.

Let me look at some specific elements that help create that symmetry.

Fiscal stability

In terms of fiscal regimes, investment is obviously attracted by favourable tax rates and discouraged by punitive ones.

However, most countries strike a careful balance and, it is the fine tuning that often makes the difference.

In the UK, for example, a couple of years ago when North Sea investment was at risk, the government and industry held detailed talks and implemented a focused set of fiscal reforms. One example was a brownfield allowance which rapidly resulted in over $3 billion of investment in some of the oldest fields in the UK continental shelf.

Local capability

Along with fiscal issues, another huge factor is the quality of local capability.

Does the country have high quality contractors and skilled workers? This is probably the most vital question in determining whether there is a strong symmetry of reward.

We work closely with host governments to build local capability because it is in everyone’s interests. Many countries have taken this on board by building centres of expertise. An MSc in Petroleum Engineering from the University of the West Indies in Trinidad & Tobago is a coveted qualification. In India, the Pandit Deendayal Petroleum

University began work six years ago and now has nearly 2000 students studying different aspects of petroleum engineering and geosciences.

A secure environment

One thing those students learn is that the risk-reward profile extends beyond explicitly financial issues.

A central consideration for our industry is whether a company can operate safely and apply its global standards in any given geography.

What is the quality of governance and institutional capacity in the country? Does the rule of law apply? Can we trust that agreements will be honoured? Can we apply our anti-corruption standards?

We need to be able to work in a way that corresponds to our Values and Code of Conduct.

This is why we are a founder member and supporter of the Extractive Industries Transparency Initiative - or EITI - and we have been actively involved in implementing it in Indonesia, Azerbaijan and several other countries with a view to establishing trust and mutual advantage among all parties.

Continuing partnerships

This takes me onto my third and final theme – what does it take for a company to go on investing in a country, decade after decade?

A good example is Egypt where BP has operated successfully for 50 years. We started work there in the Nasser era - just before the death of the former King Farouk - forming the Gulf of Suez Petroleum Company Joint Venture - GUPCO - with the Egyptian General Petroleum Corporation.

We worked on through the rule and assassination of President Sadat. We worked on through the rise and fall of Hosni Mubarak. We worked on through the brief rise and fall of the Muslim Brotherhood. And we are still at work and looking ahead – just last year we announced a new discovery from one of the deepest wells in the Nile Delta.

Why has this business endured?

It is partly because we have observed the red line we have not taken sides. But more important, it is because we have established long-term partnerships of mutual trust and advantage with institutions and individuals.

In GUPCO, 98% of the workforce were Egyptians at the outset. That was unusual in its day and an early sign of our commitment to Egypt's development. Since then the partnership has continued, trust has deepened and our business activity has grown.

Capacity investment

This example shows that the key to investment in development is to achieve the symmetry of risk and reward on an ongoing basis.

If long term opportunities and trust are both present, it logically becomes part of our wider business investment to support capacity building in areas where interests overlap.

For example, platforms used to produce gas off the shores of Trinidad used to be made largely in the US or elsewhere. But we have helped to build a local fabrication industry and the last five of BP's platforms have been constructed in Trinidad by local companies.

Azerbaijan is a nation which has produced oil for world markets for over a century – so it was a major landmark in January when production started from the first platform to be fully fabricated in the country itself. That was the West Chirag platform and its construction provided jobs for over 4,000 people. The emergence of such indigenous fabrication industries crowns the many initiatives taken to enable local SMEs to supply a range of goods and services to investing companies.

The process helps us by reducing costs and by providing us with local suppliers - and it helps the country by building its industrial base, creating a new source of income and opportunity.

Community investment

We also invest in creating the conditions for mutuality for ourselves and the societies in which we operate.

Social investment is not philanthropy. It is investment that is targeted in areas where there is a wider mutuality of long-term interest.

In Angola, for example, we have not only trained hundreds of oil and gas professionals, but more than 50 lawyers specialising in oil and gas through an International Oil and Gas Master of Law programme at the Agostinho Neto University – the first of its kind in Africa and one of a few worldwide. This is good for the country's governance capacity and it is good for the company as it provides access to local expertise.

Going even wider, in Indonesia, we have supported the training of local government officials in remote areas as these are the people who disburse the revenues accruing from our activities.

The objective of such investment is to help avoid the so-called 'resource curse' where energy becomes a temporary hotspot and other sectors wither.

This is a complex challenge and we have complemented our direct investments in building capacity with investment in the understanding of the issues by funding a centre for the study of resource-rich economies at Oxford University.

Value chain

Finally, in the context of continuing partnerships, it is worth emphasising that investment is more likely to endure if it is part of a wider value chain which is likely to endure itself. That requires an outward-looking, liberal trading regime.

For example our LNG operation at Tangguh in West Papua has long term supply contracts with Japan, China and other markets.

Our projects in the Azerbaijan section of the Caspian Sea provide oil and gas to many countries through pipelines that stretch thousands of kilometres and some of the agreements recently signed will last until 2048.

Conclusion

To conclude, where does all this lead to in terms of simple messages for policy-makers?

First, above ground conditions – open markets and business friendly frameworks enable us to apply our skills and allocate capital efficiently.

Second, fiscal stability – companies understand the need to fund public services but this should be balanced with well-targeted incentives for priority investments.

Third, capability –when policy makers build capacity in education and training they will find willing partners in industry. Employment and procurement are probably the biggest areas in which business investment promotes development.

Fourth, good governance – the rule of law is vital in ensuring stability. We do not dictate to governments but neither can we operate successfully in societies where order has broken down.

Finally, value chains –a country's investment prospects are always magnified when it fosters trade and engages in the richly complex global economy of which we are all a part.

In today's world the pace of change is relentless and there is a powerful and legitimate aspiration for progress and prosperity. In many countries where we invest, we strongly sense what Martin Luther King called the "fierce urgency of now".

Private sector companies do not operate in a vacuum. We are part of society and we too feel that sense of urgency.

Playing a part in fulfilling the aspiration for progress is essential for our own enduring success.

And that is why we want our investment to be an investment in all our interests – and to be truly an investment in development.

Thank you