

# A gas Opec in the making?

In June, the world's major gas exporting countries will meet in Moscow. They might decide to found a cartel similar to Opec. At the very least, they will agree to increase cooperation with each other.

| by Cyril Widdershoven

The idea of a gas-Opec – or Gaspec, as it is sometimes called – was first put forward by the Gas Exporting Countries Forum (GECF) on April 9 2007, when they announced they would form a study group that would look into possibilities for cooperation in the production and price setting of natural gas. The study group will report on its progress when the GECF meets again in June in Moscow.

There are many indications that some form of cooperation between the gas exporters is in the making. Chakib Khelil, Algerian Minister of Energy and Mines, declared last year that 'in the long term, we are moving towards a gas-Opec'. He did emphasise that it would take a long time for such a cartel to materialise.

Gholamhossein Nozari, the Iranian Minister of Petroleum, said in February 2008 on Iranian state radio that 'the gas producers and the countries that own gas resources should reach an agreement to establish a gas-Opec'. He too added that it was 'a time consuming process'.

In January of this year, Russian newspapers quoted Sergei Kuprianov, spokesman of the Russian national gas giant Gazprom, as saying that Russia was interested in the possibility of a new gas cartel. If all 14 members of the GECF were to join a new cartel, they would control 73% of the world's proven gas reserves and 43% of current gas production.

## Sceptical |

Many outside observers are sceptical about the commercial viability and effectiveness of a Gaspec. Justin Dargin, a researcher who worked at Opec and at the Oxford Institute for Energy Studies (OIES), says that natural gas exports in their current form are not amenable to the formation of any type of cartel. Oil is a global commodity, sold on the international market, where the prevalence of long-term fixed contracts is rare. Opec has pricing power because it can play the role of swing producer in this market. None of the potential gas-Opec members, including Russia, Qatar or Iran, can fulfil this role in the gas market. According to Dargin, any type of cartel-like organisation will have to have significant transportation reach, which will mean major investments in LNG tankers able to traverse the globe and change course at a moment's notice.

An important characteristic of the gas market is that it is dominated by long-term bilateral contracts. In such a setting, says Dargin, the development of a gas-Opec exercising the same power as Opec will be difficult, as sellers and buyers are bound together for many years. The development of short term contracts combined with an LNG spot market, to allow sellers to take advantage of arbitrage

opportunities between regions, is essential if cartelisation is to occur.

## Geopolitics |

Still, despite practical objections, the possibility of a gas-Opec cannot be ruled out. The role of LNG in the energy market is growing, supported by immense investments planned in Europe, Asia and the US for new LNG re-gasification plants. In many cases, gas producing countries have amassed the necessary capital to build their own LNG projects. The governments of those states will increasingly be able to control ownership of these projects.

It is of course possible that gas producers will not be interested in taking part in a cartel as they will need to recoup their investments as fast as possible. But continued high gas prices will lessen this need substantially. Another factor that favours a restriction of exports is growing domestic consumption in gas exporting countries.

In the end, the question might not be decided by economics at all but by geopolitical considerations. Ariel Cohen, an energy analyst with the conservative Heritage Foundation in Washington, warns that a gas cartel, set up by largely undemocratic countries with growing anti-western tendencies, will have negative repercussions for western energy security. Cohen calls for a more 'pro-active analysis by consumer countries' to counter this threat. He thinks it is possible that we are headed for 'a



Photo: Capgemini Group

total transformation of the current market' through the restructuring of contracts and shifting gas exports to more 'friendly' countries such as China or India. ■

## The Russian view

# Gaspec as an enforced option

Russia, as the largest producer in the world, would be the Saudi Arabia of a future Gaspec. What is the Russian view of the possibility of a gas cartel? EER put the question to Valery Sorokin, Professor of the Russian University of Oil and Gas, consultant to the Expert Administration of the Russian President and head of the Expert Group on Global Energy Security during Russia's Presidency of the G8. 'If Russia agrees to create such an organisation,' Sorokin says, 'it will be an option enforced upon her.'

### *How likely is it that a Gaspec will be formed in June?*

The answer depends to a large degree on the definition of a Gaspec. Due to a host of reasons, a gas replica of Opec simply is not possible. I think it will be more realistic to expect more cooperation among major gas producing and exporting countries on the basis of common interests and limitations. Even if this cooperation is institutionalised, it will be less strict in many ways than Opec's cooperation.

The official June meeting could also stimulate the establishment of a constitution of an international gas NGO that will include professional gas associations in the CIS countries. A draft of its by-laws has been circulated by the Russian Gas Society to potential participants.

### *According to some analysts, the structure of the world gas market is not conducive to worldwide pricing agreements since it is not a global market like the oil market. Is this a serious objection to a possible Gaspec?*

Yes, this is one of the major obstacles to quota/price regulation activities in the world gas business. Another closely related factor is that "world" gas pricing is heavily influenced by the global oil pricing. It is not a huge exaggeration to say that those who determine the world oil price also predetermine gas prices. In this respect it is not possible for Gaspec to play a direct role in gas price "fixing". One might say that some prospective Gaspec members can effectively influence "world" gas prices now through their membership in Opec. However it would be wrong to reduce a possible cooperation organisation of major gas producing and exporting countries



Valery Sorokin. Photo: Thierry Monasse

simply to a desire for worldwide pricing agreements. I think its goals could be wider and more universal: to ensure adequate commercial gas supplies for sustainable world economic development on the basis of mutual interests.



Algerian Energy Minister Chakib Khelil speaks to the media at the opening of the Gas Exporting Countries Forum in Doha, Qatar 9 April 2007.  
Photo: Karim Jaafar/AFP/Getty Images

*What is the Russian view towards forming a Gaspac? (Russia, unlike the other countries, is not a member of Opec.)*

I am aware of no official position or decision in this regard. There are statements from politicians and experts reflecting a whole range of opinions, from total rejection of the idea to calls for immediately establishing an organisation of gas producing and exporting countries with wide responsibilities. I think that essentially Russia views a much closer cooperation as an instrument to neutralise the efforts by western countries at the geopolitical and commercial “energy containment” of Russia. It complements Russia’s other actions to spread its risks, including through diversification of gas transportation routes and markets as well as developing a global LNG business.

We have to deal with the potential option of creating a Gaspac with great care. Sometimes radical slogans without convincing and sustainable follow-up could be more harmful to their initiators than actions themselves. Words have become not only potent derivatives of energy geopolitics, they often substitute for it.

In view of the important role of Russia in Eurasian and global energy security as well as growing confrontational trends in energy geopolitics, it seems extremely counterproductive to provoke the Kremlin’s mentality of a besieged “energy fortress Russia”. There is a better alternative – real international energy cooperation and partnership. The common energy

strategy established at the G8 summit at St. Petersburg, the Heiligendamm dialogue process, and taking the best of the Energy Charter documents are just three examples of this. If such a dialogue fails, it could lead to an “entrenched blocks” approach with a far more suboptimal global energy security. The point of no return will be reached when tens of billions of euros are invested in politically motivated and commercially unsubstantiated multilateral energy infrastructure, which will set the basic parameters of future energy supply in concrete for decades to come.

*Do you see the gas-exporting countries coordinating production levels in some way in the future?*

Not directly. But I could see a broader cooperation that would help to avoid the overinvestment of billions in unnecessary projects. Global energy security requires a balance between gas export/import diversification and reasonable predictability. In the face of multiplying blocs and cooperation formats among gas consuming countries, gas exporting countries do not have much of a choice but to respond with better cooperation among themselves, simply to avoid deterioration of their market positions. In a sense, this is an enforced option.

*Is a Gaspac necessary anyway in view of the rosy outlook for the gas market?*

Let’s turn this around: are any of the cartel-type coalitions of gas consuming countries necessary in view of the rosy outlook for the gas market? It goes both ways. Otherwise the situation

can easily get out of control. It is easy to provoke changes. It is much more difficult and painful to exercise damage control. The recent coordinated decision by three Central Asian countries (a mini-Gaspec?) to double the price of gas sold to Russia did not happen by itself. But it will not be only Russia who is affected. This could be the end of cheap gas for Ukraine too. Some geopolitical energy infrastructure projects bypassing Russia can be saved only by direct political money sponsorship, if at all.

*If a Gaspec were formed, should gas-importing countries view this as a threat?*

No more than gas exporting countries facing different kinds of organisations or coordinated policy by gas importing countries. As already mentioned, I see a Gaspec option mostly as a forced response. But cooperation, if handled responsibly, will make global energy security more transparent and predictable.

*Does the development of LNG increase the likelihood of a Gaspec? Perhaps because the gas exporting countries might lose some control of the market when LNG becomes bigger?*

Not necessarily. In the end, the same countries with huge gas reserves are involved in pipeline and LNG exports. With LNG becoming bigger, any cooperation framework will be more sophisticated. For the efficient and sustainable performance of international gas markets, it is important that neither importing nor exporting countries dominate or control them – individually or by combining together.

*Is it correct that there is already a high level of coordination among the gas companies inside Russia?*

It is a matter of definition. When Gazprom produces 85% of Russian gas, owns all its trunk gas pipelines and has a monopoly on gas exports, it says a lot about set-up of the Russian gas business. The “coordination” among gas companies happens at the entry to the gas transportation system. It is all about competition and negotiation. There is no state organisation defining what independent gas companies should be doing. The state – both its executive and legislative branches – is heavily lobbied by the independents (those who are not owners of gas trunk pipelines). The access to pipelines and its conditions are the major issues.

In the absence of direct state involvement in gas planning and taking into account the enormous lobbying potential of Gazprom, gas community organisations have a role to play. The Russian Gas Society is the most visible and active of all of them. Energy sections of business associations and the Union of Independent Gas Producers are also doing their part. There are many specific topic-oriented joint working groups run by a number of ministries, Gazprom and independents. All these forums facilitate the gas business and pave the way for making it more market-based and competitive.

Independent Russian gas producers are ready to substantially

increase the output when conditions are right. In this respect the biggest potential lies with vertically integrated oil companies (state and private). Two interlinked basic problems should be solved to get their huge volumes of associated gas to the market: reducing gas flaring to 5% and access to pipelines. There is a flurry of activity to achieve both goals. The reason why the role of independent gas producers in the Russian domestic market is set to increase is obvious. In 2011, or maybe a few years later, we will have price parity between export and domestic gas supplies. That will reduce their incentive to export. Despite the difficult conditions, no independent gas producer has as yet voluntarily quit the business. It simply is profitable. And it will be more so.

*What is your view of critics like the IEA and OECD who say that Russia does not invest enough in its gas producing capacity?*

From the gas consumers’ point of view, it is never enough. I think the situation needs a more balanced analysis. On the one hand, some of our important Western counterparts aggressively press for “decreasing dependence on Russian gas imports”. That means a reduction of Russian gas supply – either in relative or in absolute terms. On the other hand, they voice misgivings over the level of investment in the gas producing capacity in Russia. Something looks wrong with the logic. The level and structure of Russian investment in gas production are determined to a large degree by market signals from foreign consumers. In reality, these signals come through primarily by way of political statements and practical actions. So far they have been very controversial or mixed at best. It is well known that the nature of the gas business is such that no company will invest billions in gas development before it has agreements to sell the actual gas. And this is even more so now that the costs of projects has risen steeply. The key to success is in risk sharing and partnership. That is where the concept of security of demand comes in. In any case, it must be absolutely clear that all contractual export obligations by Russia will be – as always – fulfilled. There is no doubt about this. And since the contracts are for 20-25 years, this means Russian gas supplies are reliable. Precisely where Russian gas flows in the future will be determined by the market, technology and geopolitics.

*According to some experts, we are heading for a very tight gas market after 2015, for various reasons. Do you share this view?*

Basically, no. World gas reserves are sufficient to meet the growing demand under any long-term scenario. It is important to match this with other components of success – first of all, by avoiding resource nationalism, both by the suppliers but also by the consumers. Energy protectionism would be a disaster for the global economy, no matter who starts it – consuming, transiting or producing countries. It will eventually boomerang on its initiators. Only joint responsibility and a partnership approach will prevent this worst case scenario from happening. ■