

Interview Chakib Khelil, President of Opec, Algerian Minister of Energy

‘If you want guaranteed supply, you have to pay the price’

Chakib Khelil, Algerian Minister of Energy and President of OPEC for 2008, explains his country’s energy policy to European Energy Review. Speaking in his office on the 10th floor of one of the tower blocks in the Val d’Hydra district in the heart of Algiers, he warns that European countries must pay higher prices for gas if they want guaranteed supply. ‘A long-term contract is not necessarily good for us.’

| by Yves de Saint Jacob

Algeria hopes to expand its natural gas exports. Europe wants to conclude an agreement with you over a strategic partnership to guarantee supply while you yourself have often called for a guaranteed demand. Can such a strategic partnership satisfy both conditions?

Algeria is the third supplier of gas to Europe, after Russia and Norway. For us, Europe is the most competitive market in terms of distance and development potential, so it is obvious we value it very highly. As far as increasing exports is concerned, we have plans for two major new underwater gas pipeline projects, in addition to the two that already link Algeria with Spain and Italy. We are also working on the trans-Sahara pipeline between Nigeria and Algeria, which will further guarantee the supply to Europe. And we are operating two new gas liquefaction plants in Skikda and Arzew. We have been negotiating for two years over the strategic agreement. In terms of discussions, the deal has practically been sealed, although I can’t say when it will be finalised. The decision to sign is a political one.

What does the strategic partnership involve?

It is a global framework for harmonising our rules and regulations, for encouraging investment, diversifying our resources towards renewable energy and nuclear power, improving the efficiency of our energy, conservation, and so forth. Those are the main principles. Algeria has already made great strides in the area of hydrocarbons and electricity. Investors can, and do, do whatever they want in Algeria, there are no restrictions on European companies operating in Algeria. When it comes to guaranteeing supplies for Europe,

we are doing all we can – and I can’t see what more we could do. Because 90% of our gas is exported to Europe, we are very dependent on the European Union. But something that is becoming a real problem between European and Algerian companies, and something that must be resolved, is the question of gas prices in long-term contracts. The long-term contract is good for the European partner because it guarantees supply but it is not necessarily a good thing for us, because it obliges us to revise our prices and the revision depends on the good will of the European companies – and that is not always forthcoming.

Is that why you want more short-term contracts?

Effectively, yes. We would prefer short-term contracts because we believe that could help us overcome the problem of price. Prices within long-term contracts are considerably lower than “spot” prices and that is not right. Either you want guaranteed supply and you’re prepared to pay the price for that, otherwise all contracts have to be short-term contracts.

But surely delivery by gas pipeline has always meant long-term contracts to guarantee a return on investment?

Our existing pipelines have all already paid for themselves, so we no longer have a need for long-term contracts, we could convert them all into short-term contracts. There is no reason why, even with the new pipelines, we should opt for long-term contracts. It all depends on how profitable we want to make them and everything depends on the price of gas.

As for the “spot” market, it is more to the advantage of European

companies than it is to Sonatrach. Why? Because it allows them to divert their tankers to where they can get the best price for their gas. And that is done on our backs because we are constrained by having to send our gas by pipeline. Take Spain. The Spanish market should be free, open and competitive, but I don't believe that is the case. We negotiate with Gas Natural, our customer at the other end of the pipeline, to provide gas for four dollars. They probably sell it on the Spanish market for ten dollars. They can also send LNG (Liquefied Natural Gas) on to the American market for twelve dollars or to Japan where it sells for 29 dollars. The Spanish people benefit, which is only right, but the companies are abusing their ability to divert supplies. This is the same company that is our partner in the pipeline. Now, if we had short-term contracts, I could say, 'I'm not selling any more, I will only sell if I can get ten dollars.'

Will the agreement you are drawing up with Europe improve the situation?

The main problem is that if I sign an agreement with the European Union, what good will it do if I still have problems with each of its members? So, when we talk about guaranteeing supply, we have to stipulate that it is for all of Europe, not for a single country.

On the other hand, if you want guaranteed supply, the rules have to be fair and equitable. If one of the two parties considers the terms are not really fair, that raises the problem of contractual stability and so threatens the guaranteed supply. No fairness, no stability.

You forged closer links with Gazprom earlier this year. This was a cause for concern in Europe. What is the current state of affairs?

There was a Memorandum of Understanding between Sonatrach and Gazprom, as there was with Statoil and Shell. It wasn't anything special. There was a lot of publicity about it at the time because it came at the same moment as the Ukrainian crisis. Europe felt threatened, while all we had done was sign a normal agreement. That agreement expired last August. We intend to renew it if the Russians wish to. It is a question of developing joint ventures in prospecting, production and transport, in all spheres. The Russian companies have operations in Algeria, because Algeria is open to everyone. But Sonatrach does not

'There are no restrictions on European companies operating in Algeria'

have any projects in Russia, or any joint ventures with Gazprom outside of Russia or Algeria.

When do you expect the new agreement to be signed?

That depends on Sonatrach and on Gazprom. During my visit to Russia, we spoke to Khristenko [then Russian Minister of Energy, ed.] and agreed that both parties should do so if they judged it to be useful.

Won't the European countries be worried?

Let them worry. Where is the problem? I also worry about many things. I worry about the problem of the price Europe is paying for gas. I am working to change that. If Europe is worried, it only has to work in the same direction. I don't get the impression that it is. Europe must have a common policy. I don't think it is moving in the right direction. There is no European regulator; everyone does what they consider to be in their own interests. How can you adopt a common policy if every country holds a separate policy?

Another cause for concern among consumers is the prospect of a producers' cartel. The Gas Producing and Exporting Countries' Forum is due to discuss the possibility in Moscow.

The Moscow meeting has been put back until October. We have set up a working party, under the chairmanship of Russia, to analyse the possibility of creating such a body or of reinforcing what already exists, namely the Forum. It has played a key role in the exchange of information and experience and allowed the countries involved to work together.

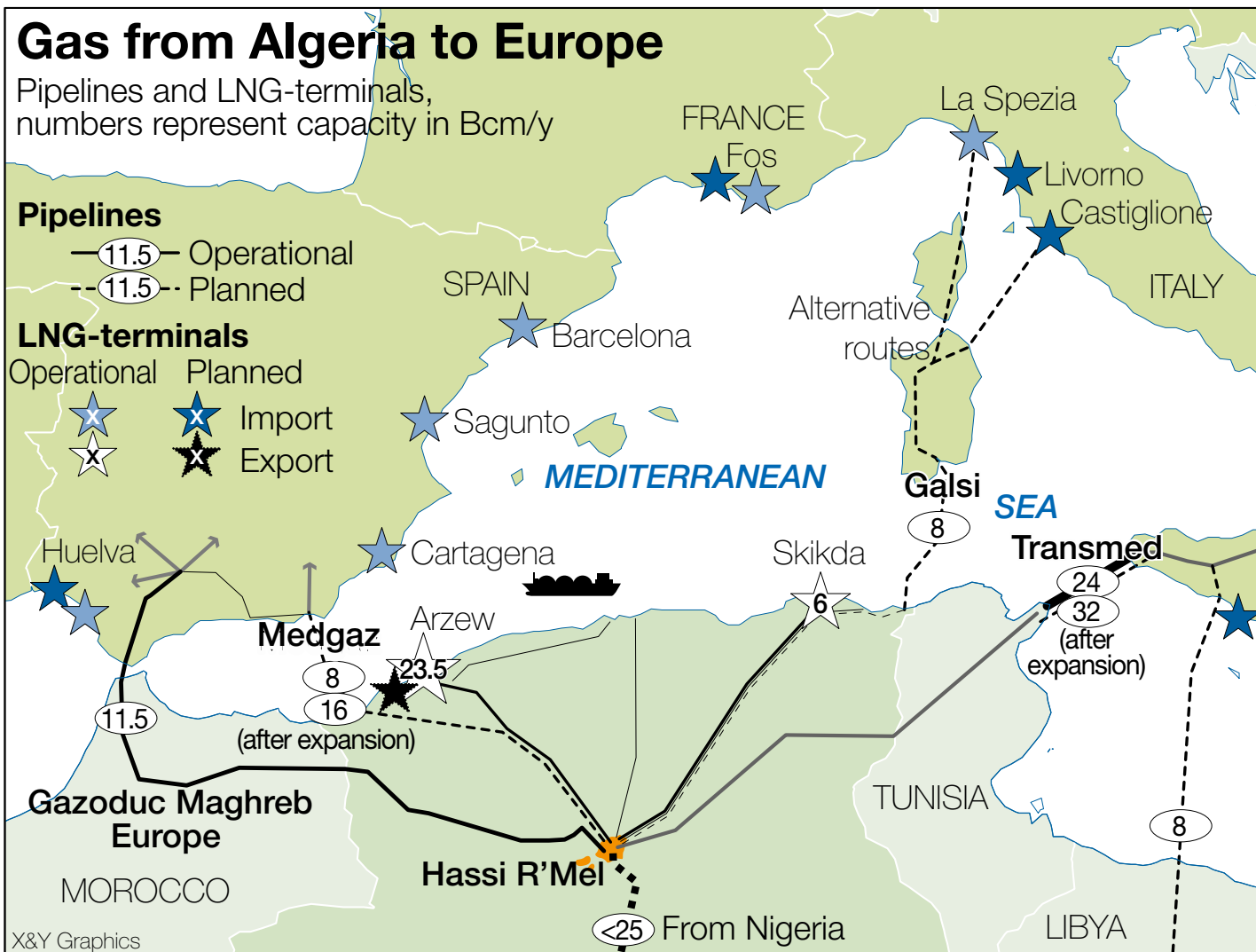
The working party has almost completed its task. In October, we will know the outcome of its deliberations as well as its recommendations. On the other side of the coin, consumer organisations are doing the same thing, so there is no reason why the producing countries should not exchange information that concerns them.

But are we heading towards a cartel, a sort of gas version of Opec?

I believe we are moving towards a stronger Forum, which will be better equipped to exchange information to allow us to work better together in terms of optimising our resources. Take the case of LNG. We have transport capacities that could serve other producers and exporters, like Qatar and Russia, for example.

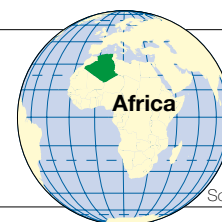
But that is not the same as intervention at the production level.

That cannot be done, simply because all the contracts are long-term contracts, under which the prices are indexed to those of oil. Could it be done in 10 or 15 years? It is a possibility as there will be enough short-term contracts based on the daily



PowerhouseOil and gas in Algeria
(data 2006)

	Production	Exports	Reserves	R/P ratio
Oil in mln barrels	2	1.8 per day	12,300	16.8 years
Gas in bln of cubic meters	84.5	60.3 per year	4,500	53.3 years

X&Y Graphics
Source: BP and EIA

“spot” market prices for us to be able to reach an agreement on the amount of production. But I don’t think Europe should feel threatened by the existence of such a body. The Forum has played a positive role and will continue to do so. It has an interesting role to play, especially when it highlights problems. For myself, I would emphasise again the question of prices, which could become a serious problem. If there is no agreement on prices, we cannot talk about guaranteeing supplies, in so far as I have a guaranteed demand, as well as the option of revising prices in line with market forces.

Where is this to be discussed?

Wherever possible. It was the same for oil prices, where, if you remember, we had a dialogue of the deaf. When the price was at 10 dollars, consumers would not listen to talk of 20 dollars. Today, no-one wants to hear talk of 100 dollars. We will have the same problem with gas. It is better to talk about it in order to resolve the problem, because it could degenerate into a problem for the guaranteed supply of gas for Europe. We have to ask the question: what is a fair price in an evolving market like that for gas?

So, according to you, what is a fair price?

The problem of a fair price does not arise for a “spot” market. It only arises over long-term contracts. These are kept at a very low level, while the “spot” markets have been developing since 2005. The indexation principles do not take this important evolution into account. Discussions have already begun on the subject of contracts, as in Spain with Gas Natural. In our 1995 contract, there is a clause that stipulates if the state of the oil market alters substantially, the two parties must negotiate. We held discussions for two years but we didn’t get anywhere. In the end it went to arbitration, but you can’t call in an arbiter every five years! As far as Gaz de France is concerned, we do not have a pipeline link but we supply them with LNG. We have reached a deal whereby we have set up a company that sells to the most lucrative market and then we split the profits. When it comes to the pipelines, we should strike a similar deal. It is a problem that it is vital we resolve. As for the Italians, they are paying a reasonable price after both parties negotiated what we consider a fair deal.

Europe is moving towards a single market for gas and electricity. How do you view that?

I don’t believe this single market will be achieved. I don’t think

that what the Commission is proposing is in the process of being achieved. It affects the guarantee of supply for Europe because you are going to supply the person who offers the best price, not necessarily to give guarantees of supply to everyone. Each one will make their own arrangements, if there is no single market.

About renewables, you have a diversification plan. You are going to open a hybrid centre using gas turbines and solar panels at Hassi R’mel. It has even been suggested you could have the capacity to export 6,000 MW of solar power to Europe by 2020. Is this really feasible?

There are some extremely optimistic people around. When I hold meetings with my solar power managers, I tell them it’s all very nice but we have to keep our feet on the ground. It’s technically possible but economically, how do you go about it? Our plan is to implement the 150 MW gas-solar hybrid project and in future discover the scope for projects to compete for profitability with gas. The main problem with solar power is storing the energy once you have produced it to be used at night. We want to create a network with Hassi R’mel at its centre and to focus on storage. Our aim is to develop the technology so that in 20 years, solar energy will be truly competitive.

Germany is pushing you into solar power, France is pressuring you towards nuclear energy. Isn’t it all a bit divisive?

No, I think it is all part of the diversification of sources of energy. It is a policy we apply in every area; diversifying products,

‘We are not going to have a nuclear power plant and let others run it for us’

customers and sources. Solar power will have an important role to play, and so will nuclear energy. The relative role of each will be determined by the economic profitability for the state. Nuclear power has two drawbacks: enriched uranium has to be imported and the treatment has to be done elsewhere. If they both cost the same, I would prefer solar power. Finally, there is the problem with nuclear waste and where to store it. We know a bit about this as there were nuclear tests in Algeria (*carried out by France before independence in 1962, ed.*)

You have signed nuclear agreements with the United States and with France.

All these agreements are merely agreements in principle. We will carry out research together and train people together but we will not privilege one or the other. When it comes to the production stage, we will put it out to tender, that is our procedure in every sphere. And before we get into nuclear power, we have to pass laws. We are preparing a bill on the peaceful use of nuclear energy and it is nearly ready. It concerns the safety agency and training of specialists. For the moment, we don't have any managers or technicians. We are not going to have a nuclear power plant and let others run it for us! We must have Algerian managers.

Turning to oil, you are the president of Opec and you have not discounted the prospect of the price of oil reaching \$200 a barrel. Your analysis, like that of Opec, is that it is not a question of what is on offer.

In fact, contrary to what many people think, today's market is not based on factors existing today, it is based on factors that people judge to be a probability in the future. What do they see? Venezuela and the threat of an embargo by the United States,

Iran and the fear of military action, the war in Iraq, the instability of Nigeria. They also look at the American presidential election: there are those who say John McCain has a good chance of winning and that he would carry on the same policies as George Bush. We can also see the threats by American politicians, including the Democrats, against Opec.

There is a tendency towards confrontation. This atmosphere of conflict comes on top of the subprime crisis, the devaluation of the dollar and the actions of speculators that pushes prices up. But it is this problem of the uncertainty of the future that creates the volatility of prices.

If there were no geopolitical problems, if the dollar returned to its value of two years ago, then we'd be looking at \$60 or \$70 a barrel, which would reflect the balance between supply and demand. However, there is one trump card the Europeans hold. Until now, the European Central Bank's one aim is to curb inflation, so it has kept interest rates high and the dollar has fallen. Will the bank change tack? Europe is losing out in terms of competitiveness. At a certain point the ECB will perhaps take account of this and start to lower its rates. That could help strengthen the dollar and see the price of oil drop. ■

Chakib Khelil, politician and energy expert

Chakib Khelil was born in August 1939 in Oujda, Morocco, close to the Algerian city of Tlemcen. Shortly after Algeria's independence from France, he won a scholarship to the United States and in 1968 obtained his doctorate in oil engineering from the University of Texas. He then worked as an engineer for Shell, Phillips Petroleum and the McCord Research Department before becoming the head of the deposits department at Sonatrach in 1971, the recently nationalised company that was to be the economic driving force of Algeria and a kind of "state within the state".

On the recommendation of Bouteflika, the then foreign minister in the Boumedienne government, he was appointed Presidential Technical Advisor from 1973 to 1976. In 1978 he was placed in charge of the country's hydrocarbon development programme. Khelil believed that 'the reserves should not be considered as static' and that a major effort was needed in prospecting, using the best technological tools available. He was quoted in El Moudjahid on March 12 1979 as saying 'we have to manage scientifically to safeguard the future'. From 1980, under the rule of President Chadli, he moved on to carve out a long career with the World Bank. For nearly 20 years, he followed oil production plans throughout Africa, Latin America and Asia, building up a thorough knowledge and understanding of every project and acquainting himself with all the leading players on each continent.

Khelil became advisor to President Bouteflika in 1999 and inspired his programme of liberalisation before being appointed Minister of Energy and Mining in December of the same year. He convinced the president that a marriage between liberalism and nationalism was possible and resisted attacks by those who saw him as a dangerous liberal and a puppet of the United States, although they succeeded in forcing him to abandon plans to privatise Sonatrach.

Khelil is currently the Algerian Minister of Energy and President of Opec for 2008, the second time he has been appointed to the position. He is proud of his long career and reaffirms his belief that 'technology will enable us to push back the limits of oil and gas reserves even further', adding that 'we are not about to see the hydrocarbon reserves exhausted in Algeria'.