Who's afraid of a gas cartel?

Are the big gas producers setting up a cartel à la Opec? Most experts argue that the structure of gas markets makes the gas business much less amenable to cartelisation than the oil business. If that is true, why are so many people in the gas industry afraid of a gas cartel?

by Alex Forbes

One morning last October, delegates gathering at a natural gas summit in Paris were looking forward to hearing a speech from one of most powerful people in the business – Abdullah bin Hamad Al Attiyah, deputy prime minister and energy minister of Qatar, the world's largest producer of liquefied natural gas (LNG). But they were to be disappointed. The minister did not turn up. He had been detained by urgent business in Tehran with two other powerful gas people: Alexey Miller, chairman of Gazprom, the world's largest gas producer and exporter, and Gholamhossein Nozari, Iran's petroleum minister.

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The previous evening – on 21 October – these three giants of the gas business had announced that they were forming a "big gas troika" to advance their common interests as gas producers and exporters. This added fresh fuel to a long-running debate: whether a forum of gas-exporting countries (the Gas Exporting Countries Forum or GECF) formed some eight years ago – also at a meeting in Tehran – might one day evolve into an OPEC-style gas cartel. Following the Tehran meeting, Miller told journalists, 'We are united by the world's largest gas reserves, common strategic interests, and high potential for co-operation within tripartite projects. We have agreed to hold regular meetings of a big gas troika three-to-four times a year to address the crucial issues of gas market development. We believe that such consultations may contribute greatly to building the Gas Exporting Countries Forum's agenda. We share a common vision of the forum's goals and tasks, as well as the need to rapidly transform it into a permanent organisation promoting reliable and stable energy supplies across the globe.' Nozari was much less measured in his statements – he was widely reported as having told journalists: 'There is a demand to form this gas Opec and there is a consensus to set up this gas Opec.'

Reaction to the formation of the "gas troika" was mixed. One British newspaper, The Guardian, wrote that, 'Western concerns about global energy markets hit new heights last night when Russia, Iran and Qatar said they were forming an OPEC-style gas cartel.' But at the Paris gas summit, Gérard Mestrallet – president and chief executive of the recently-merged Suez-GdF, one of Europe's biggest gas companies – said that, 'The project involving a forum of gas producers doesn't necessarily have to follow the cartel rationale. If it is a forum for dialogue that will enhance visibility and transparency when it comes to prices, and if it involves a sharing of a long-term

Iran's Oil Minister Gholam Hossein Nozari (center), Qatar's Minister of Energy and Industry Abdullah bin Hamad al-Attiyah (left) and Alexi Miller (right), CEO of Russian gas company Gazprom, hold a joint press conference following a meeting in Tehran on October 21, 2008. Photo: Atta Kenare/AFP/Getty Images

vision, then we would be favourable to the creation of such a forum. As a major buyer of gas, we are in favour of partnership with producer countries.'

No substance

At the centre of concerns about the formation of the "gas troika" is the simple fact that these three countries are the world's largest holders of proved gas reserves, together accounting for 56% of the global total. Moreover, Iran and Qatar are the only two gas producers in the Middle East and North Africa (Mena) region with sufficient proved reserves to feed both large and growing domestic markets and substantial incremental exports, whether by pipeline, LNG or gas-to-liquids (GTL).

This is not to say that Russia, Iran and Qatar are presently in a position to collude to an extent that need worry gas consumers in the short to medium term. Those who believe that an Opec-style gas cartel is not currently feasible are on pretty solid ground and their arguments well-rehearsed.

- Most gas is currently sold under long-term bilateral contracts between a single seller and a single buyer. These stipulate in detail the delivery terms and the basis of the price, usually with a linkage to oil and/or oil products.
- Gas markets remain regional rather than global, with their own individual physical infrastructures, contracting structures and price formation mechanisms.
- Gas in its primary market, power generation, can be substituted by coal, nuclear power, renewables or indeed oil, whereas oil's role in transportation is not easily substitutable.
- The three members of the "gas troika" currently face several issues of alignment: Russia will be exporting gas mainly by pipeline, even when Sakhalin Energy, its sole existing LNG project, comes on stream; Qatar exports mainly in the form of LNG; while Iran is a net importer.
- Some feel there is little need for a gas cartel as gas producers piggy-back on an existing cartel – Opec – because most gas contracts are priced on the basis of linkages to oil or oil products.

The view of Professor Jonathan Stern, an acknowledged expert on Russian gas at the Oxford Institute of Energy Studies, is that, 'There's been a lot of discussion about the GECF – but as far as I'm concerned, this is largely something that journalists love and has no substance whatsoever ... I'm with those people who say, well, in ten years it might grow into something. Before then, forget it.' But Stern later amended his view, saying in the Financial Times that, as a result of the current low oil and gas prices, a gas cartel 'does become more of a threat'.

There are more people who are worried. At the European Autumn Gas Conference (EAGC) that took place at Lake Como in northern Italy at the end of November, I was presented with an unusual opportunity to canvass opinion on the issue. One of the features of the EAGC in recent years has been a series of questions that delegates are asked

to vote on during the proceedings, using an electronic polling handset. This year, I was commissioned by the sponsor of these questions, Gas Strategies, to come up with 18 questions for this exercise, in collaboration with the firm's managing consultants. One of these questions, was: With Russia, Iran and Qatar controlling 56% of world gas reserves, how concerned should policy-makers be about greater co-operation between supplier countries? I was surprised to see that, of the several hundred delegates that took part – all experts in the business – as many as a quarter voted that the formation of an Opec-style gas cartel is a major threat in the long term and should be strongly resisted. Another third felt that while the GECF has not yet led to cartel behaviour it might as regional markets globalise.
Another quarter took the more optimistic view that the structure of gas markets and contracts makes gas less amenable to cartel behaviour than oil, while 13% took the resigned view that there is little that consuming countries can do to prevent such co-operation, so why worry? Only 8% felt the same way as Gérard Mestrallet, believing that policy-makers should not be at all concerned because greater co-operation in making gas available is a good thing and should be supported.
So amongst an audience that could hardly be described as "uninformed", more than half the delegates harboured concerns about possible price collusion in natural gas in the long term.

Professor Jonathan Stern of the Oxford Institute for Energy Studies

'We are united by the world's largest gas reserves and common strategic interest'

I believe there are reasons to be concerned in the long term. The key issue, especially for regions facing a tight gas market going forward, such as Europe, is not what the gas producers are expected to do, but what they would be capable of doing if they so chose. While it is true that long-term contracts will form the basis of most gas trades for the foreseeable future, the development of spot and short-term trading, especially in LNG, is accelerating. In some markets, notably the US and the UK, gas-to-gas competition has become the norm, even when gas is delivered by pipeline. Gas markets are becoming increasingly liquid and interlinked. Events in one regional market – whether it be a nuclear shut-down in Japan, or a sudden revival of gas production growth in the US – already can have dramatic and immediate effects on other markets. The example of how the LNG business has metamorphosed over the past decade suggests that business-as-usual cannot be assumed in the long term.

Moreover, protestations by the "gas troika" – which were repeated at the most recent meeting, in Moscow on December 23 – that their association is not aimed at the formation of a cartel cannot be taken at face value. Their declared intention that co-operation between producers is primarily aimed at obtaining stable markets in the interest of both producers and consumers borrows much from the literature of Opec. Besides, there is no consumer representation within the GECF, unlike the Riyadh-based International Energy Forum (IEF), whose whole raison d'être is to bring together consumers and producers.

On the question of the political and business alignment between the big three, while there may be little alignment at present it could – indeed is likely to – increase in the future. Russia will sooner or later develop more LNG; Qatar, once its moratorium is reviewed, will play a greater role as an exporter, by LNG and pipeline; and Iran, sooner or later, will become a major exporter by both pipeline and LNG. As globalisation and liquidity increase, scope for co-operation – and collusion – will broaden.

Most of the major gas markets – notably Europe and the major LNG consumers in Asia, Japan and South Korea – have few, if any, realistic alternative options to natural gas for power generation, as demand continues to grow. The current global financial and economic crisis may dampen energy demand but probably only in the short to medium term. An important factor in gas demand growth will be concerns over climate change. These will remain a key factor in energy investment decisions. As carbon pricing takes hold, gas, as the least-polluting of the fossil fuels, will gain a growing economic advantage.

Even a basic analysis of long-term gas supply suggests that in the absence of very large discoveries elsewhere – always a possibility – Russia, Qatar and Iran are likely be the world's main exporters of gas post-2020. This is not to accuse these countries of being intent on collusion. But if they chose to, the potential might arise – and such a gas grouping might be more effective at influencing prices than Opec has been, as least in recent times. Moreover, both Russia and Iran have shown an appetite for using their control of energy supply for political ends, while Qatar's growing political influence in the Middle East has been partly driven by its gas wealth.
For those consuming countries that see themselves as dependent on natural gas for their energy futures, complacency no longer looks a sensible option. ■