A RUSSIAN-LED „OPEC FOR GAS“ ? DESIGN, IMPLICATIONS, COUNTERMEASURES

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Introduction

In April 2007 the Gas-Exporting Countries's Forum (GECF) held its sixth annual meeting in Doha, Qatar; and will meet in Moscow in April 2008. The group had been dormant until very recently, informal and barely noticed. But the Doha meeting took the first step toward creating a cartel-type system at the inter-governmental level that could control a lion's share of gas supplies to Western countries. Russia is the main factor in this initiative, and the upcoming meeting in Moscow can be expected to move closer to forming an exporters' cartel.

Commentators tend to portray this initiative as a "Gas OPEC." Should it materialize, however, it would not work like OPEC; but it would be all the same a cartel-type structure. An expert group commissioned by NATO had anticipated this development. It reported in November 2006 that Russia would seek to form a gas cartel in the context of using energy resources to achieve political objectives.

The GECF includes 15 member countries, among which Russia, Iran, Algeria, and Qatar rank as largest gas exporters and/or estimated-reserve holders worldwide. From its first meeting in Tehran in 2001 until this year, the group had disclaimed any intentions to control prices and volumes of gas supplies to Western consumer countries. This attitude is now changing, however, as the group's majority including the three leading countries are considering ways and means to form a cartel. Qatar's ultimate position seems uncertain (it had to show even-handedness as host and chair of the Doha meeting).

Western gas-exporting countries – Canada, Norway, the Netherlands – oppose this initiative, as does the West-oriented Azerbaijan. The Central Asian

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countries, lacking alternative export outlets, could end up in a Russia-led subgroup attached to the cartel, adding to Russia's leverage over themselves and others, unless the West offers Turkmenistan and Kazakhstan direct access to European markets.

One obvious rationale of the proposed cartel has to do with the pricing of gas. However, Moscow almost certainly thinks farther ahead. It sees gas production almost stagnant in Russia, internal consumption rising, shortfalls looming, and Russian export commitments jeopardized in the years immediately ahead, even as Western demand rises. Moscow may well conclude that other suppliers will seek to open or broaden access to Western markets. If so, Russia probably wishes to control that process by means of cartel-type arrangements that Russia could still dominate as the leading exporter by far. Through the proposed cartel Moscow could obtain a significant say in the relationships between Western consumer countries and suppliers other than Russia.

1. Design: from Doha to Moscow

The Doha meeting decided behind closed doors to set up a High-Level Group that would develop a common methodology on the formation of gas export prices and would conduct research on consumer markets. The High-Level Group, consisting of deputy ministers or departmental directors, is to discuss relevant proposals from member governments and submit proposals for possible decisions at GECF's April 2008 meeting.

Russian President Vladimir Putin twice made trial-balloon statements in favor of a gas cartel during the run-up to the Doha event, also while visiting Qatar just before the Forum's meeting.

Russia stands at the forefront of this initiative by dint of its disproportionate strength, compared to other GECF countries, in terms of gas reserves, field technology, own export potential, control of key transport routes, presence on lucrative markets, and rapidly growing network of bilateral relations with the other states in the group. Russia offered to host the next meeting, serve as coordinator of the High-Level Group, lead the market research studies on price formation, and finance a large share of the Group's activities (apparently by covering the shares of impoverished member countries of GECF).

Some of the more radical or impatient governments – such as Venezuela, Bolivia, and Iran – called during the Doha meeting for creating a cartel immediately and then proceeding with research on price formation and market studies as the next step. A more sophisticated Russia, however, supported the sequence of steps that was eventually adopted at the Forum: research first, cartel afterward.

Russia fielded a powerful delegation led by Industry and Energy Minister Viktor Khristenko, Gazprom's president Alexei Miller, and vice-president Alexander Medvedev at the Doha meeting. These officials – as well as Valery Yazev in Moscow, chairman of the Duma's Energy and Transport Committee and president of the Russian Gas Society – hinted then and since, sometimes broadly and sometimes obscurely, at Russia's expectations regarding a cartel-type structure of gas exporters. Those expectations do not presuppose the formation of a full-fledged cartel, but can be pursued through a cartel-type group, with cartel-type arrangements in selective areas.

Thus, Russian expectations seem to focus on:

- Agreeing on common methods of price formation;
- Allocating specific markets in consumer countries or regions to specific exporting countries, by understandings among the latter;
- Avoiding competition among gas-exporting countries within the group on given markets or new ones (an intention that would clash with the European Union's competition policies);
- Ensuring "market reliability" by Russian definition (that is, a long-term lock on sizeable market shares);
- Reaching strategic understandings within the group on export volumes and schedules of delivery in various directions;
- Agreeing in advance within the group on new pipeline projects (this would enable a cartel-type group to sustain its own arrangements about market allocation to specific exporters);

- "Joint" exploration and development of gas fields in member countries (this would imply Russian access to gas reserves of member countries and marketing the product under Russian control);
- Coordinating start-ups and production schedules at newly commissioned gas fields in member countries; and
- Plan jointly for development of gas liquefaction plants and export of LNG.

2. Implications

Between the Doha and Moscow meetings, according to Yazev, „Russia may take up the integrating role in the gas cartel's creation." GECF's meeting next year in Moscow might create a standing body, such as an executive agency or a secretariat. That would indicate progress toward forming a cartel.

The widely used term „OPEC for Gas" is of course a misnomer. Oil for the most part is moving freely on the world's oceans and is largely traded in a global market. Gas, however, moves largely through single-destination pipelines and is therefore traded mostly in sub-regional and national markets (as long as liquefaction remains limited). OPEC can push price levels up or down, in short-term fluctuations; whereas gas supply contracts are, as a rule, longer-term.

A gas cartel's main role would be one that OPEC by definition could not play in the case of oil: namely, determining the destinations and routes of energy supplies from producer to consumer countries, practically allocating certain markets to certain suppliers on a long-term basis. A gas cartel can do that. The essence of a gas cartel would be division of market shares and apportionment of niches among its members. Such a cartel could, moreover, introduce quantitative ceilings to exports in specific directions, so as to limit the drawdown on member countries' reserves and maximize the price.

Unlike OPEC, such a cartel could involve a set of regional arrangements that allocate certain markets to certain suppliers, fix prices in those specific markets, coordinate delivery volumes, and even plan exclusive LNG development projects.

Russia would be strongly placed to set cartel rules for allocating gas markets by capitalizing on Russia's far superior export potential, its entrenched dominance in some European countries, and its control of some major transit systems and routes to Europe. Given that most gas exports move through single-destination pipelines to sub-regional or national markets (as long as liquefaction remains limited), any cartel-type group could consist of only two or three gas-exporting countries operating effectively in a specific market. For example, Russia's Gazprom could consider "sharing" certain European markets with Algeria's Sonatrach. Conversely – but also as part of cartel-type arrangements – Gazprom and another exporter in this group can agree to stay out of each other's market niches in certain European countries. As another example of a regional cartel in formation, the South American Gas Organization was founded by Argentina, Bolivia, and Venezuela, member countries of GECF. Ultimately, an overall cartel that would evolve out of GECF could function as an umbrella organization for regional and subregional cartel-type groupings or arrangements.

If created, such a cartel would be dominated by Russia, which is the world's largest reserve holder, producer, exporter, and transiter of gas. Russia could shape a gas cartel's behavior to an extent similar to Saudi Arabia's dominant role in OPEC, although with different methods, some of which are outlined above.

During 2006 and 2007, Gazprom and other Russian companies have entered into gas development projects in Algeria, Libya, Bolivia, and Venezuela (the latter is an up-and-coming exporter of gas). Russia seeks entry into gas projects in Egypt, other Arab countries, and Trinidad & Tobago (a significant exporter of liquefied gas). Thus Gazprom's agreements include exploration, field development, and marketing. These activities tend to undermine the position of European and North American gas-importing countries, in effect raiding the West's traditional and/or prospective sources of supply.

3. Central Asia is not included in the proposed cartel

Putin had first launched the idea of a Russian-led "alliance of gas-exporting countries" in 2002, focusing mainly on Turkmenistan but also on Kazakhstan and Uzbekistan. Putin's proposal triggered a first round of international debate on a mislabeled "OPEC for Gas." There was no follow-up, however, and neither Russia nor any combination of gas-exporting countries felt strong enough to challenge the West at that time.

In essence, Putin's proposal meant that Russia would buy those countries' gas cheaply and re-sell much of it in Europe expensively. Or, as a twin option, it would use low-priced Central Asian gas in Russia, so as to release equivalent volumes of Russian gas for high-priced export to Europe. This exploitative system is increasingly taking shape on a bilateral basis, under Gazprom's control outside any cartel. In effect, it amalgamates Central Asian countries' gas with that of Russia, into a single pool under Russia's physical and commercial control. This is a far greater measure of control than Moscow could ever exercise over the gas exports of any countries in the proposed cartel.

Unsurprisingly, therefore, Russia does not mention Central Asian countries as possible members of the gas cartel. There was no public record of participation by Central Asian countries in GECF or the Doha meeting. Moscow would not willingly allow Central Asian countries into the exporters' cartel. Russia would rather maximize its own strength within the proposed cartel by handling itself the gas exports from Central Asia. Moreover, Russia wants to buy Central Asian gas at lower prices than a cartel's prices. Central Asian gas volumes not used within Russia would reach Europe through Gazprom's pipelines as "Russian" gas.

Iran and Russia seem to be the pace setters in this initiative in the run-up to the Gas-Exporting Countries' Forum (GECF) meeting, scheduled for April 9 in Doha. On January 29 2007 in Tehran, Ayatollah Ali Khamenei publicly proposed the formation of a gas-export cartel to the visiting Igor Ivanov, Secretary of Russia's Security Council. Iranian President Mahmoud Ahmadinejad has also signaled support for this idea. Iran pursues the specific interest of developing its vast gas fields, which are ranked potentially among the richest worldwide, but are undeveloped because of international and U.S. sanctions.

Russia regards Iran as a potential competitor, whose eventual gas exports should be directed toward Asia, consigning the European markets to Gazprom and its lesser partners such as Algeria's Sonatrach.

4. Possible countermeasures

The European Union and the United States have a number of good options to forestall the emergence of a Russian-led gas cartel. The question is whether Brussels and Washington are willing to act on these options, and act preventively.

First, moving decisively to open direct access to Central Asian gas on competitive terms. Turkmenistan, with an export potential far exceeding the current 60 or so billion cubic meters annually, is a key to diversifying Europe's gas supplies. Kazakhstan's inputs would be smaller but not insignificant. Washington and Brussels have lost five years through inactivity on the trans-Caspian pipeline project. Its reactivation must not be confined to the tapping of offshore fields only. Turkmenistan's binding supply commitments to Russia from onshore fields run out in 2009.

Second, preparing now for the day when development of Iranian gas fields becomes politically possible; and trying politically to bring that day closer. Keeping Iranian gas locked in the ground can not be a sustainable policy in the context of rising demand and prices, limited availability, insufficient competition, and excessive Russian leverage. Gazprom may well end up managing and controlling the entry of Iranian gas to export markets through the proposed cartel. Azerbaijan can help kick-start the first phase of the Nabucco project or the Turkey-Greece-Italy project. But the second-phase volumes would have to be within sight already during the early first phase.

Third, boosting liquefied natural gas development outside Gazprom's influence. LNG development is rightly seen as one of the means to counter Gazprom's dominance. However, Gazprom seems set to acquire LNG technology from Algeria's Sonatrach and from several Western companies – in some cases as quid-pro-quo for allowing those Western companies "access" to Russian gas fields. At the moment, Gazprom is planning a series of gas liquefaction plants, including one near St. Petersburg, complete with a fleet of tanker ships line to carry the LNG via the Baltic Sea.

The GECF's April 2008 meeting in Moscow might not announce the formation of a gas cartel, but may well lay the foundation for one. The EU and the United States are presumably watching closely.