Russie.Nei.Visions n°24

Russia and the "Gas-OPEC". Real or Perceived Threat?

Dominique Finon

November 2007

ifri
Russia/NIS Center

The Institut français des relations internationales (Ifri) is a research center and a non partisan forum for debate on major international political and economic issues. Headed by Thierry de Montbrial since its founding in 1979 , Ifri is an independent state-approved organization.

Created in March 2005 as the Brussels-based branch of Ifri, Eur-Ifri aims to contribute to the diversity of policy-thinking in Brussels with a view to stimulating the political debate and to feeding the decision-making process in the EU institutions.

The opinions expressed in this book are the authors' alone and do not reflect the official views of their institutions.

Russia/NIS Center

ISBN

IFRI
27 RUE DE LA PROCESSION
75740 PARIS CEDEX 15 – FRANCE
TEL. : 33 (0)1 40 61 60 00
FAX : 33 (0)1 40 61 60 60
E-MAIL : ifri@ifri.org

EUR-IFRI
22-28, AVENUE D'AUDERGHEM
B – 1040 BRUXELLES
TEL. : 32(2) 238 51 10
FAX : 32 (2) 238 51 15
E-MAIL : info.eurifri@ifri.org

WEBSITE **:** www.ifri.org

Russie.Nei.Visions

Russie.Nei.Visions is an electronic collection dedicated to Russia and other new independent states (Belarus, Ukraine, Moldova, Armenia, Georgia, Azerbaijan, Kazakhstan, Uzbekistan, Turkmenistan, Tajikistan and Kyrgyzstan). Written up by key experts, these policy-oriented papers deal with strategic and political issues as well as economic issues.

This collection guarantees Ifri's quality standards (editing and anonymous peer-review).

If you wish to be notified of upcoming publications, please send an e-mail to: info.russie.nei@ifri.org

Previous issues

– Thomas Gomart, "The EU-Russia Dialogue: A New Impulse with Nicholas Sarkozy?", *Russie.Nei.Visions,* No. 23, October 2007;

– Louis-Marie Clouet, "Rosoboronexport, Spearhead of the Russian Arms Industry", *Russie.Nei.Visions,* No. 22, September 2007;

– Oksana Antonenko, "Russia and the Deadlock Over Kosovo", *Russie.Nei.Visions*, No. 21, July 2007.

Author

Dominique Finon is Research Director at CNRS. An engineering graduate from the *Ecole Centrale de Lyon* and a Doctor of Economics, he headed the *Institut d'Economie et de Politique de l'Energie* and currently heads the *Laboratoire d'Analyse économique des Réseaux et des Systèmes Energétiques* (LARSEN) in Paris. His research focuses on the reform of the energy industry and the liberalization of markets. In the framework of various European networks, he has co-edited several studies on the competition within integrated gas and electricity markets in Europe. He is the author of several books and articles, among which: *Reshaping European Energy Networks: Regulation, Markets and Strategies* (with Atle Midttun), Editions Elsevier, 2005 ; "Russian and European Gas Interdependence. Could Contractual Trade Channel Geopolitics?" (with C. Locatelli), *Energy Policy* (to be published in November 2007). Having worked as a consultant for the Ministry of Industry, several energy companies and the European Commission, he is currently President of the Association of Energy Economists.

Contents

Summary

The threat of a gas-OPEC, waved around by certain big producers, has given rise to much fear in consuming countries. The behavior of Russia, a key exporter, has made it seem as though gas sales could be used as a political weapon. In truth, the creation of an *entente* between exporting countries is not technically feasible. What is more, Russia remains reticent to join any association in order not to limit its room for maneuver. Seeking to dominate the world market, it has singed a certain number of agreements with other big producers. Nevertheless, the capitalistic constraints of the gas market jeopardize the chances of long-term coordination, which is incompatible with short-term political interests.

Introduction

The Russian gas market is a privileged instrument through which Russia has sought to stand out as a political power. The latest expression of this mixture between energy policy and gas politics was the dissemination, in 2006, of the idea of a gas-OPEC that suggested the control of prices through the cartelization of the market. This prospect has generated much fear, notably in European countries. Amidst a context of political tension with Russia in the aftermath of the Russia-Ukraine crisis, the European Union (EU) worried that such a cartel might be created. In November 2006, North Atlantic Treaty Organization (NATO) experts warned governments that such a cartel could be used for "political leverage on Europe."[1]

At the same time, Russia is seeking to expand its leadership in the global gas market through successive regional or bilateral agreements with Central Asian and North African countries (Algeria and Libya) and through a rapprochement with other important gas-producing countries, like Qatar and Iran. This leadership aims to coordinate long-term projects between the diverse producing countries, leading to the fear that Russia, along with other exporting countries, could provoke price increases by a coordinated restriction of investment.

In reality, such strategy is difficult to implement because of features intrinsic to the gas market which constrain the possibilities for its manipulation. The creation of a gas cartel that would alter deliveries to increase prices has never been considered as a realistic scenario by the gas industry.[2] This scenario has also been rejected by a number of important producing countries, such as Algeria and Qatar, and was finally dropped at the Gas Exporting Countries Forum (GECF) meeting in Doha in April 2007. However, possibilities for long-term coordination continue to be debated by industry observers, though coordination must overcome competing interests as well as the long timeframe that such agreements would imply.

Translated from French by Jessica Allevione.

[1] Conclusion of the report by the NATO Group of Experts cited in the *Financial Times*, 14 November 2006.

[2] As noticed by Jonathan Stern, renowned specialist of European gas markets, in J. Stern, "Gas-OPEC: A Distraction from Important Issues of Russian Gas Supply to Europe", *Oxford Energy Comment*, February 2007, available at: <www.oxfordenergy.org/comments.php>.

An Improbable Cartelization

The control OPEC exerts on oil prices can serve as a frame of reference. This control is achieved by the setting of quotas three times a year, and the subsequent increase or decrease in the quantity delivered on the market, depending on the global economic situation. Adjustments are primarily made by the swing producers, who own most of the resources and have low production costs. This model is not applicable to the natural gas market, even if it is possible to imagine Russia and Qatar—future leader in the market for liquefied natural gas (LNG)— being in a position to split the role of swing producer; insofar as Russia controls the regional European market and Qatar the world LNG market.

The bright future of long-term contracts

Outside the North-American market, short-term contracts remain the exception. In Europe and Asia, gas is marketed almost solely on a long-term basis, typically between 20 and 25 years. It ensures minimum purchases and determines prices by indexing them on the price of oil and petroleum products, that is to say, without any link to an independent, short-term gas market. Russia sells almost all its gas to Europe in this way. Such contractual agreement is sought both by the producers, in order to ensure the proper development of their capital-intensive operations, and by consumers, who see such agreements as the best way of managing risk in an otherwise non-fungible spot market.[3] The commercialization of large quantities of gas and infrastructure, as well as the development of fields ever-further from the consuming markets, will require investments to be framed by long-term contracts. It will not be possible to have sufficiently developed spot markets to allow for the emergence of reference prices for transactions. The long-term contract will remain the main form of marketing gas, which will render control over the quantities on the market quite difficult. Using such a model in order to increase prices will thus not be possible.

It is true that long-term contracts are now relatively flexible in regard to the quantities delivered (with a margin of around 10-20%); it would thus be possible for producers to coordinate policies in order to reduce levels,

[3] A spot market refers to anonymous short-term transactions made in relation to the financial market and aimed at covering risks.

thus forcing buyers to turn to the short-term market and increase the spot price. Yet what would be the logic behind such a move, since the vast majority of supplies are sold at long-term set prices and not indexed on spot prices? What is more, if large producers were to play significantly upon the quantities supplied by contract, and not only on the spot market, this would quickly lead to contractual defaults. Given the importance of these contracts for exporters, purposefully tearing them up would bring into question the countries' future capacity to sign new contracts and thus finance investments.

It is worth adding that the continued indexing of contractual gas prices on the price of oil and petroleum products (in 85% of transactions outside the United States) would indirectly perpetuate such a situation. Knowing that the high price of oil will probably persist, it is all the more unlikely that producers will abandon such long-term contracts in favor of short-term ones and spot sales. Due to the uncertainty of prices on the gas market, buyers are no more ready to promote new formulas for indexing prices in current contracts on spot prices. In other words, by guaranteeing the stability of oil prices in the medium- and long-term, OPEC remains the best defender of gas prices. According to some experts, "big producers such as Algeria or Iran already defend their gas interests during OPEC meetings." [4] Russia, which only has observer status in OPEC, could be induced into following the organization's decisions in order to maintain prices.

Poorly integrated regional gas markets

While the oil market is global and homogenous, the gas market is divided into regional markets. This is because of technical differences in the infrastructure tying producers and consumers (modes of transport for gas being less flexible and more difficult to reverse) both with regard to pipelines and the LNG supply chain. The North American, European and Asian markets are autonomous, with different commercial habits and specific infrastructure:

– in the United States and Canada, trading is primarily based on medium-term contracts and spot transactions, facilitated by highly developed gas pipeline infrastructure and the close proximity of gas fields;

– in Europe, trade is primarily performed via pipelines and only partially by LNG, with long-term contracts indexed on the price of petroleum products, and from increasingly distant fields;

[4] Interview of S. Boussena, international expert, former OPEC President and former Algerian Minister of Energy and Mines, "La formation d'un cartel sur les prix du gaz est impossible" [Creating a Cartel on Gas Prices Is Impossible], *La Tribune*, 19 March 2007.

– in South and East Asia, trade rests solely on the LNG supply chain, with long-term contracts as standard, and prices that are firmly indexed on the price of oil.

These regional markets follow their own practices. Aside from Qatar, few producers are in a position to supply two of these export markets thus bringing the short-term markets in line with prices. It is nevertheless true that by transatlantic LNG trading, there is a growing capacity to be selective when choosing between the North American and European markets. With the on-going increase in importation capabilities on both sides, a significant price difference between these markets will lead to the circumstantial redirecting of shipments from one market to the other, until flows are stabilized by regional spot prices. Yet these adjustments will not affect the main flows contracted in Europe and Asia.

Exporter rivalry

Agreement within OPEC countries owes much to their homogeneity. In the gas market, the possibility of reaching an agreement between the main producers is severely limited by the heterogeneity of exporting countries and main suppliers of the international market. Developed exporter countries (Australia exports to Asia and the U S; Canada to the US; Norway and the Netherlands to Europe) will never agree to an *entente* on principle.[5] Other countries are reluctant because of their crucial need for the technological and organizational capabilities that large international companies have at their disposal.

Countries that are emerging as gas exporters (Qatar, Nigeria, Egypt, Angola, Trinidad and Tobago) rely on narrow partnerships with international oil & gas companies. These companies develop resources in the framework of Production Sharing Agreements (PSA) and supply LNG technology. For a gas OPEC to function these exporters would need to submit their short-term production and long-term gas strategy to the decisions emanating from a coalition of other states. This is an improbable scenario. Since early 2007, Qatar and Nigeria have declared themselves unfavorable to the idea of the GECF becoming a gas-OPEC. On the other hand, Iran, who for foreign policy reasons is the most active advocate of such an organization, and can afford to be because of its vast reserves, refuses to genuinely associate itself with foreign companies in developing its LNG capacity. Yet such a step is absolutely necessary if it wishes to penetrate the export markets from which it is entirely absent.

---

[5] Norway, which is only a GECF observer, is completely integrated to the EU's competition regulation by a partnership agreement, and has refused to belong to any cartel at the April 2007 meeting in Doha.

What about a long-term global coordination?

If the cartelization of the world gas market is highly improbable, it is still necessary to examine the possible effects that long-term coordination between producers might have. This is the framework within which Russia's projects and bilateral exchanges with other important gas exporting countries, such as Qatar and Iran, must be analyzed.

It goes without saying that this constitutes a less visible form of coordination than cartel price control. Harmonizing the development of capacities, pipeline projects and LNG supply chains in order to avoid temporary over-capacity on a particular regional market and limit competition between projects would bring down costs for both sides. This form of coordination would also benefit consumers by limiting the uncertainty and volatility of the market.

Such coordination would nevertheless risk morphing into a tacit *entente* to under-invest in production and transit apparatus in order to exert pressure on prices. In a world where supplies seem limited, coordination between suppliers to limit investment (or simply to limit the contractual obligations of gas export contracts) is not difficult to envisage. In November 2006, the International Energy Agency (IEA) voiced concern over the possibility that Russia and Iran were seeking global cooperation via a transformed GECF. [6]

Three obstacles confront this possible transformation:

– A strict coordination of natural gas' international or regional development is not foreseeable, as it would need to encompass all the market's actors and not only a small group of dominant actors (Russia, Algeria, Qatar and later Iran), even if these hold over half the world's reserves.

– It would imply very-long-term commitment by the participants, which presumes their credibility. From this perspective, could Russia itself be considered credible? It is worth remembering that Russia has failed to demonstrate such credibility in many other fields.

– Lastly, were the big exporters to impose such investment and contractual restrictions upon themselves, the main buyers would certainly seek to divide the members of the alliance and to seek new supplies.

[6] IEA news report, 6 November 2006.

The possible cost for Russia

It is worth questioning Russia's will to embark upon international coordination of short-term exports—as a cartel would—or even of long-term ones—as the strict coordination of export projects would require. A perennial characteristic of Russian foreign and trade policies has always been the refusal of any system of alliance in order to maintain its room for maneuver.[7] On the issue of natural gas, Jonathan Stern, an expert on Russian energy, believes that Russia's behavior in relation to OPEC demonstrates how Russia would never be able to subjugate itself to collective rules, particularly when it comes to playing the role of a swing producer in a cartelized market.[8] Russia has never sought to integrate into OPEC, to do so would mean subjecting its hydrocarbon sales to commercial rules dictated by others, notably through the joint reduction of quantities exported. Despite a possible political interest in being an active OPEC member, and thus able to influence its decisions, Russia has preferred to stand back as an observer. It benefits from price increases linked to OPEC controls without participating.

It is easy to imagine that Russia might conceive its leadership role in a possible cartel as one that would lay down production limits while not limiting its own production. Similarly, in regard to long-term coordination, Russia is likely to impose its own projects upon others. This certainly seems contrary to the setup required for the creation of a cartel or the form of cooperation discussed above.

[7] See in particular the introduction by T. Gomart in the *Politique étrangère* special edition, « La Russie. Enjeux internationaux et intérieurs » [Russia: International and Domestic Stakes], Th. Gomart and T. Kastouéva-Jean (eds.), September 2007.
[8] J. Stern, *op. cit.* [2].

Iran: Ally or Competitor?

A prolonged period of low gas prices beginning in 1998, indexed on the price of oil, had by 2001 already prompted Russia and Iran to call in Tehran for the creation of the Gas Exporting Countries Forum. The Forum's instigators aimed to establish the coordination of prices and quantities delivered on the long-term market.[9] At the second meeting, in Algiers in 2002, Russia called upon Eurasian countries to form a tighter alliance in order to exert control on volumes according to their destination, and to weigh on price-formation.[10] Despite price increases since 2003, a certain level of mobilization has remained because, meanwhile, the European Commission has sought to impose upon big vendors outside the Community. The Commission desires the relinquishing of current long-term contracts or, short of this, the reduction of their length and modification of fundamental clauses that block short-term competition.[11]

Nevertheless, the GECF is struggling to find its rightful place. Established in a buyers' market when low prices encouraged cooperation among producers, the Forum has not raised much interest in its members since the situation was reversed and oil & gas prices went up again. It has remained an organization without a charter, without statutes or a permanent secretariat and with a changing constituency, giving the impression of an uncertain future.[12] During each of its five meetings between 2001 and 2006, the Forum has dealt with the structure of gas contracts and price formulas, technical issues on the international transportation of gas as well as new market prospects for natural gas.

[9] Its membership has varied: in 2006, it comprised 15 members (Algeria, Brunei, Egypt, Indonesia, Iran, Libya, Malaysia, Nigeria, Oman, Qatar, Russia, Trinidad-and-Tobago, the United Arab Emirates, Venezuela) and an observer, Norway. The loudest members in 2007, Iran and Venezuela, are no even exporters and are in a politically and technically difficult spot to become important exporters in the next twenty years.

[10] See H. Hallouche, *The GECF*: *Is it Really a Gas OPEC in the Making?,* Oxford, Oxford Institute for Energy Studies, 2006.

[11] This is particularly the case of final destination clauses. Long-term sales contracts signed before the liberalization of markets constrain the buyer to sell the contracted volumes in specially designed countries, which allows for netback pricing, that is, figuring out the price of energy by subtracting the transit cost between these countries. This final destination clause thus compartmentalizes the market into national grids, bringing in anti-competition methods and the price discrimination the exporters' national border.

[12] See also S. Boussena, J.-P. Pauwells and C. Locatelli, *Le Défi pétrolier. Questions actuelles du pétrole et du gaz* [The Oil Challenge. Current Issues in Oil and Gas], Paris, Eyrolles, 2005. See also J. Stern, *op. cit.* [2].

The idea of close cooperation between producers was revived by Iran in June 2006, demonstrating its willingness to confront the West.[13] Russia let the idea spread without formally approving or condemning it. The main driving force is not economic, since the market has never been so favorable to sellers, since the gas price, indexed on the price of oil, has never been so high on regional markets. In light of Russia's tougher foreign policy, Moscow's desire is to counter the European Union, which was deeply marked by the Ukrainian-Russian crisis. Russia has reacted to Europe's wishes for a strong common energy policy, notably with its March 2006 Green Paper,[14] by arguing that, since consumers coordinate their actions, gas exporters only stand to lose ground in negotiations if they act in isolation from one another. This reaction reflects the feeling of isolation that often guides Russian foreign policy.[15]

Having received great media coverage, the idea of a gas cartel being established via the transformation of the GECF was a way of getting attention by letting people believe in the Forum's influence as it prepared for its seventh meeting in Doha (Qatar) in April 2007. The promoters of the cartel idea are playing the fear factor in a world where energy needs are fast increasing. This idea is shrewdly used to encourage belief in the return of a North-South confrontation, over natural gas, just like in OPEC's heyday after the first oil shock. Such an idea is manifest of Russia's ability to influence world affairs in a logic of assertion intended to mix political and commercial influence. The extra political weight Russia gains from its enormous resources in natural gas is in line with President Putin's broader vision of seeing the BRIC's (Brazil, Russia, India, China) economic power translate into political power.[16]

That being said, the Russians are not oblivious to the obstacles that block the formation of a gas cartel similar to OPEC. It is Iran who first suggested such an organization in June 2006 at the Shanghai Cooperation Organization (SCO) Summit, and pursued the idea during a meeting between Ayatollah Khamenei and Igor Ivanov in January 2007[17]. Russian policy-makers generally deny the existence of such a project to control prices and quantities, underlining that their prime objective was to progressively reach a coordination of long-term projects in order to avoid

[13] At the SCO Summit in June 2006 President Ahmadinejad of Iran (an observer) claimed that a gas and energy coordination would "counter the threat of dominant powers and their aggressive interference in world affairs." Cited in S. Blagov, "Russian Moves Park Gas OPEC Fear", *ISN Security Watch,* 10 July 2006.
[14] European Commission, Green Paper "A European Strategy for Sustainable, Competitive and Secure Energy" (COM(2006) 105 final), Brussels, 8 March 2006.
[15] The deputy and former president of the Duma Guennadi Seleznev, taking up the theme of the producers' isolation, sees a gas-OPEC as a very realistic idea: "We are isolated and the creation of a cartel would be very useful: it is not excluded that this one day be realized as an organization. " Cited by RIA Novosti, 29 January 2007.
[16] Putin's speech at the conference on security issues, Munich, 9 February 2007.
[17] Indeed, on 29 January 2007, the Ayatollah Khamenei suggested the creation of an organization for gas cooperation with Russia during a meeting in Tehran with Igor Ivanov, at the time Secretary of Russia's Security Council, when preparing the GECF's 7th meeting in April Doha.

their overlap.[18] Yet this did not prevent Putin from declaring more than once, in the beginning of 2007, that “a gas-OPEC is an idea worth studying,” all while adding that “it is not for tomorrow” and that “Russia seeks dialogue with other countries first and foremost.”[19]

In April 2007, the GECF’s Doha meeting marked the apogee of the threat of a gas cartel. The objective—to increase media pressure—was achieved since numerous observers, both in Europe and the US, dramatized the possible ramifications of an agreement by underlining the fact that Russia, Iran, and Qatar’s combined reserves represent over half of world reserves.[20]

The meeting nevertheless failed to transform the GECF into an organization. As early as January, Algeria had distanced itself from this position, due to the objections from the country’s oil directors. Qatar and Nigeria opposed it in order to safeguard their credibility with major international energy companies. Russia did not seek to impose the creation of such an organization, leaving Iran in the front line, backed up only by Venezuela and Trinidad and Tobago in favor of the cartel idea.

The GECF will thus not be transformed into a gas-OPEC. Russia has simply convinced its partners to create a High Technical Commission, which it will finance in large part. The Forum’s objectives were clarified on several points: to seek the homogenization of price clauses in contracts in order to reduce competition among suppliers; to be progressively informed of the evolution of export projects; to develop a model of the world market in order to facilitate forecasts; to cooperate with regard to new transport and liquefication/regasification technologies; to propose a framework for dialogue with the consuming nations. This is therefore far from the OPEC model.

---

[18] Russia only seek the la coordination of long-term projects, as underlined by Gazprom president Alexei Miller, in February 2007: “The big gas producers have an interest in agreeing on long-term strategies in the fields of exploration, production, and exportation, as well as the optimization of investment projects”, (*La Tribune*, 19 February 2007). The Russian Minister of Industry and Energy, Viktor Khristenko, also denied any project of cartelization of the world market under Russia’s aegis, instead advocating a long-term consultation, underlining that this would contribute to the stability of supplies to consuming countries. (RIA Novosti, 18 March 2007).

[19] “In the first stage we seek agreements with our Iranian partners as well as with other countries that extract large quantities and deliver them to world markets. We are making efforts to coordinate our actions on the markets with third countries.” V. Putin, press conference at the Kremlin for Russian and foreign journalists, 1 February 2007, available at: <www.kremlin.ru>. Returning from his trip in Qatar, the Russian President still claimed that “the idea of a cartel was not rejected. Knowing whether it is necessary to establish one or not is another question”, Press conference held after the negotiations between Russia and Qatar, 12 February 2007, available at: <www.kremlin.ru>.

[20] Paolo Scaroni, President of ENI, has also voiced the concern that an alliance between three or four large exporters (Russia, Iran, Qatar, Algeria) would be sufficient to control the price of gas (in R. Amsterdam, “Russia and the Gas Cartel, Part III: The Doha Meeting”, 6 April 2007, available at:
<www.robertamsterdam.com/2007/04/russia_and_the_gas_cartel_part_2.htm>).

The initial reading of such a mobilization of the gas producers echoed broader currents demonizing Russia as an unpredictable power, and perceives the gas-OPEC as an eminently political idea in the minds of Russian policy-makers, a way of showing off its strength to the West.[21] Russia took advantage of Iran's pugnacity in order to raise the idea of a price-fixing cartel without discrediting itself. By letting Tehran aggressively pursue this idea, Moscow made it seem as though it was the progressive force behind the far more credible goal of longer-term coordination. With this in mind, the desired effect was clearly achieved.

The true nature of Russia's relations with other gas producers is certainly more nuanced. This essay aims to put forward another reading, which was suggested by an employee of the Russian Ministry of Energy during a personal conversation.[22] This reading sees Russia as caring about its own credibility in international gas relations and as conscious of the risk posed to future trade relations by using sales for political ends. What is more, the calls for cartelization by "stubborn countries" and largely taken up in the international press would have greatly inconvenienced Russia. Since the debate was impossible to avoid, it would have preferred to let it run its course in order to channel it and avoid the radicalization of gas producers. The Russian proposal to better structure the GECF's activities under its own aegis reflects this thinking.

[21] This position is frequently voiced by the Russian expert Vladimir Milov, President of the Institute of Energy Policy, Moscow.
[22] Interview in Moscow with the author, 19 September 2007.

Assuming Gas Leadership

Russia is developing a policy of bilateral and regional cooperation in the gas market which clearly reveals desire for a leadership role. Numerous analysts worry about this desire and its geopolitical consequences.[23] Russia and Gazprom have signed agreements with Central Asian producers and their companies; Russia is negotiating with Iran, a future exporter, and with Qatar, the main LNG exporter: it has signed protocols with Libya and importantly with Algeria. The idea of a gas-OPEC that would be the framework for long-term coordination would appear to be the crowning objective.

Taken as a whole, these agreements cannot be separated from Russia's specific foreign policy objectives. It sees its projected power as emanating from its preeminence on the energy scene, this would be achieved through regaining influence in Central Asian countries, reclaiming influential positions it had in Soviet years, notably in Algeria and Syria, closing deals with countries hostile to the US which have large reserves—such as Venezuela and Iran. Nevertheless, in the final analysis foreign policy objectives often lead to industrial risk taking. This leads to heterogeneous and contingent deal making. This cannot form the basis of a future dominance in the international gas market.

Cozying up to Central Asian countries

The development of Russia's gas leadership first requires control over the production and exportation of gas from Central Asian countries. It must avoid direct sales to Europe from these countries, or at least have them under control. Harmonizing the development of these countries' production—Turkmenistan first and foremost, but also Kazakhstan and Uzbekistan—and the means by which this production is evacuated to

[23] For a very critical analysis of Russia's behavior, see V. Socor, "Russian Energy: Toward a Russia-Led 'OPEC for Gas'?", presentation at the Jamestown Foundation, 25 April 2007, available at: <www.jamestown.org/events_details.php?event_id=31>. According to this expert, to control the world market Russia would have to rely on several "different regional sub-cartels", and on alliances to penetrate the expanding LNG market from which it is currently absent.

Europe, China, and even South Asia, will determine the odds of Gazprom establishing control on the global market.[24]

For these countries, the US-EU strategy of transporting gas by routes that avoid Russian territory is rife with uncertainties.[25] As far as oil is concerned, this has led to three Transcaspian pipelines, but as far as gas is concerned, no credible alternative to pipe Turkmen gas for example has been developed in over ten years. The reason is economic: the existing infrastructure going through Russia is sufficient to advantageously handle all exports. This undermines the financing of alternatives, since Russia can always offer Central Asian countries a better price, thus pre-empting the long-term contractual obligations needed to build a Central Asian gas pipeline.

This situation explains the evolution of narrow gas agreements with Russia: creation of joint ventures with Kazakhstan and Turkmenistan in 2001; Memorandum of Understanding with Turkmenistan on gas sales in 2003, consolidated by a 25-year export contract signed in 2005; agreement on the exclusive production of Uzbek fields for 25 years signed in 2006, itself the product of a 2004 PSA signed with Gazprom; and, finally, in May 2007, an important agreement between Russia, Kazakhstan and Turkmenistan aimed at coordinating the development of both production and transit routes. This agreement also aims to organize the export of gas to European markets by doubling the annual capacity of transport to Russia, currently at 80 bcm. A formal long-term coordination has thus emerged, allowing Russia to harmonize Central Asian interests with its own. Held hostage by existing infrastructure, these countries nevertheless have leverage allowing them to maximize gas revenues. Indeed, Russia has an interest in purchasing large quantities of Central Asian gas before it invests in its own domestic production in order to satisfy internal demand and future export markets. The agreements therefore look sustainable.

Limited coordination with Algeria

With regard to Algeria, Russia is a far cry from this type of coordination. Two Memoranda of Understanding (MoU) were signed in August 2006 and January 2007 amidst high tensions between the EU and Russia. On

[24] It is not possible here to detail the competing projects for exporting Central Asian or Caspian energy to the European market.

[25] See Nadia Campaner's analysis in her thesis entitled *Les Fondements de l'interdépendance énergétique entre l'Union européenne et la Fédération de Russie* [The basis of Energy Interdependence between the European Union and the Russian Federation], Université Paris III, Ecole doctorale Espace européen contemporain [Doctoral School on the Contemporary European Space], 21 October 2006. See also N. Campaner, "Asie centrale: Gazprom, l'œil de Moscou" [Central Asia: Gazprom, Moscow's Eye], *Alternatives internationales*, September 2007, p. 34-36.

several occasions the European Commissioner for Energy, Andris Piebalgs, accused these two countries of wanting to create a cartel.[26]

Russia's aim in 2006 was to use natural gas as an entry point to establish broader relations with Algeria. The general MoU of August 2006 encompassed cooperation in various fields: nuclear electricity, sales of military aircraft, defense systems, and gas projects. During the first negotiations in February 2006, Putin proposed that Algeria exchange the foreign debt it owed to Russia (US$ 4.6 billion) for a significant stake in Sonatrach's capital. Concerned about its autonomy, Algeria refused.[27]

The MoU of January 2007 shed more light on the cooperation between Gazprom and Sonatrach. It concerned production and transit projects, but in no way planned a coordination comparable to that which exists between Russia and the Central Asian countries. Negotiations had envisaged numerous areas of cooperation: sharing LNG technology by associating Sonatrach to a projected gasification terminal in St. Petersburg, Gazprom's participation in a Transmediterranean pipeline, Gazprom's participation in the exploration and production of new fields, trading of LNG (a new departure for Gazprom), etc. For Algeria, this agreement is primarily political, and does not present clear benefits, aside from possible financial contribution by Gazprom to developing Europe-bound pipelines.[28]

Fears of a "duopolization" of the European market by Russia and Algeria are utterly unfounded. Certainly, Algeria has some common interests with Russia, as when it faced heavy EU pressure in 2002 and 2004 to revise contracts underway. It is possible to think that, even if the present MoU do not go into great depth, they could be the first step toward greater collusion between the two countries. Yet Algeria wishes to maintain it strategic autonomy and does not wish to see its credibility on the international market questioned. Cooperation should therefore only pertain to upstream projects and infrastructure, and will not include the coordination of prices or quantities put on the European market or the development of projects to Europe. Sonatrach deals with Gazprom the way it deals with Shell, Great Britain's Centrica or Norway's Statoil, by defining partnership on common projects. Similarly, Gazprom deals with Sonatrach in the same the way it dealt with Statoil on particular shared projects in May 2007, which no one denounced as concealing a cartelization project.

[26] See for example his comments cited in the *Wall Street Journa*l, 19 January 2007.
[27] See the very useful analysis of Russia-Algeria gas cooperation: H. Darbouche, "Russian-Algerian Cooperation and the Gas OPEC: What's in the Pipeline?" *CEPS Policy Brief,* No. 123, March 2007.
[28] *Idem*.

Future rivalry with Iran

At first glance, Russia has found in Iran an ally allowing it to enact the broad coordination between producing countries it desires, as Tehran overplays its part through incantatory rhetoric, aiming to turn natural gas into a weapon of economic assertion and political resistance in the face of American superpower. Relations between Russia and Iran remain nonetheless difficult to read, and in any event are marked by strong rivalry.[29]

It is worth first remembering that Iran, second in terms of global resources, uses up its production domestically. The development of its huge fields and the infrastructure necessary to export (notably via LNG) is contingent on the LNG projects of major oil companies. Gas pipeline projects to South Asia via Pakistan, or to Europe, imply tight cooperation with several countries that is difficult to imagine, given the Iranian regime's behavior.

Russia wants to establish itself as a partner helping to develop Iran's gas exports.[30] On 16 June 2006 at the SCO Summit, Putin announced that Gazprom was ready to contribute to the financial and technological requirements of the Iran-Pakistan-India gas pipeline or an offshore pipeline for domestic use. Natural gas can be understood as one element among others (sale of refineries, nuclear power plants, weapon systems, etc.) with which Russia is seeking to become the mediator in the conflict that has Iran pitted against the international community over the development of uranium-enriching capacities.

It remains to be seen if Iran's ambitions do not clash with those of Russia in the long-term. Iran would for example benefit from the realization of the EU-supported Nabucco gas pipeline project linking Caspian gas to the European market via Turkey, bypassing Russia. Possible rivalries would certainly surface if a gas-OPEC, which Iran calls for, were established, with the primary intention to coordinate long-term projects. In any event, no agreement aimed at coordinating activities between Iran and Russia has yet been considered or even suggested.

[29] See the excellent analysis of the complex relationship by F. Fee, "The Russian-Iranian Energy Relationship", *Middle East Economic Survey*, vol. XLIX, No. 11-12, March 2007.

[30] It is worthwhile adding that another one of Russia's objectives is to control the evacuation of Central Asian gas to the south via Iran. Gazprom will contribute to reinstate the Turkmenistan-Iran gas pipeline built in the Soviet era. Joint ventures for transiting gas are also planned.

No alliance between Qatar and Russia

Visiting Doha in March 2007, President Putin attempted to rally Qatar to the idea of reinforced coordination between producers. Indeed, its strategy of building up leadership would not be very credible without including this country, the main exporter of LNG (100 million tons a year by 2010). Russia wishes to enter the LNG market by developing its exports to the North American and Asian markets.[31] It can only conceive of leading the world gas market if it gets along with Qatar. Gazprom aims to master the technology quickly and in January 2007 even stated its interest in participating in Qatar's fourth LNG project. However, none of this allows us to infer the possibility of a framework agreement with Qatar establishing the broad principles of regional market allocation.

Qatar, which has a cooperation agreement with the US and is developing its LNG capacities in partnership with the energy majors, does not wish to ally itself with Russia. It does not seek to make grand gestures and opposes the possibility of a gas-OPEC. While it may have an interest in flexible consultations within a producers' Forum aimed at harmonizing the price clauses of futures contracts, it is nevertheless in a position to control its own development strategy independently, by choosing credible partners and conducting projects within its own timeframe. The gas trade, with its inherent long-term constraints, will always mix competition and cooperation. Qatar is and will remain one of Russia's competitors, and one to which worried buyers turned to after the January 2006 Russia-Ukraine gas dispute.

[31] Gazprom still aims to market some of the Shtokman gas in the Barents Sea via LNG, in addition to the Far-Eastern LNG sales (Sakhalin) control of which it wrested from the majors.

Conclusion

The concept of a gas cartel is now part of the media's "off-the-peg ideas" and geopolitical shortcuts. Contributing to this impression of threat from cartelization and the idea of a gas-OPEC is a fundamental lack of understanding of the basic setup of the world gas market, the constraints linked to infrastructure development, and the nature of the market. The gas industry is particularly vulnerable to a discrepancy between political and media rhetoric and industrial reality, which is characterized by inherently long timeframes necessitating the credibility of actors' commitments.

This tendency, combined with Russia's desire to demonstrate the influence that its vast natural resources confer upon it, does nothing to simplify our understanding of what is at stake in gas relations. By showing off its influence via its energy resources, Russia willingly fuels fears that its present administration does not seek to dispel.

Russia has not been the only country attempting to utilize the phantom of a gas-OPEC, but it has predominantly sought to control the dialogue between producers. At the same time, it has allowed the idea of a cartel to spread without seeking to fight it, probably in order to counter the EU's desire to launch an external energy policy aimed first and foremost at the threat which Russia is supposed to pose.

Seen thus, Russia's attempt to lead the world gas market by establishing long-term coordination under its control is very real. When Russia and other countries talk of coordination in the field of natural gas, it concerns the coordination of projects, not the creation of a cartel. The aim would be to avoid competing projects in order to limit operating costs and capital investment, and undoubtedly to increase their negotiating power vis-à-vis European and Asian consumers. In the end, Russia's strategy is more demonstrative than effective, due to the constraints weighing on developing natural gas as well as competing interests. These factors constrain the possibilities for formal coordination and will undermine the stability of such coordination in the long-term. Thus, it is worth noting that, outside its zone of influence in Central Asia, Russia has failed to develop timely alliances, this is in part due to foreign policy goals, as was the case with Algeria.

It is thus imperative to disassociate rhetoric from facts by taking into account the commercial realities of the gas market, its investment requirements and the various interests at stake. Believing in the threat of cartelization means playing Russia's political game. Seen thus, Russian

Minister of Industry and Energy Viktor Khristenko's call to "stop playing politics with energy" is good counsel.[32]

[32] Viktor Khristenko as cited in *L'Expansion*, 1 July 2007.