

Russia's abuse of its energy muscle is not good news for its citizens, it is not good news for its neighbours and it is not good news for the world. The masters of Gazprom, Russia's state owned gas giant have made no bones of their desire to keep big energy projects in the family and do not shy from making life difficult for those who, domestically might seek to challenge them. Loutish behavior also characterises Russia's behavior towards its near abroad, Ukraine, Georgia and Belarus although the latter are far from blameless. Russia's government is of course not the only one to try and achieve a larger share of the takings as oil and gas prices ride high but its current behavior towards foreign companies working in Russia could well backfire if the price of oil and gas drops substantially.

Most comments since the interruption of Gazprom supplies through Ukraine, first in 2006 and then again in January 2009, have focused on the European Union's dependence on Russian gas. In 2007 Norway which accounts for 27% of all gas imported into the European Union (EU-27) gave a pledge as a "reliable energy supplier", a theme which has been at the heart of that country's thinking ever since it started exporting gas. The creation of a Norwegian energy powerhouse, the consequence of the \$30 billion merger of Statoil with Norsk Hydro offers comfort to European buyers but gas production from Norway is expected to increase only until 2013 and then plateau.

Little is heard publicly or written about Europe's third largest supplier of gas, Algeria, which accounts for 20% of the continent's imports. Yet Algerian exports of gas have doubled since 1994 to 60bcm the bulk of which go to Europe. By 2010 Algerian exports will probably reach 85bcm. Europe will remain, as it will for the foreseeable future by far, the largest customer of Algeria's state company Sonatrach. The context in which such a rise is occurring is summed up by two figures: the European Union projects that gas imports will increase to 80%-90% of EU-27 demand by 2030 while the International Energy Agency predicts that OECD European gas dependence on gas imports will increase to 65% by the same date.

Some fears were expressed about the potential threat of domestic terrorism on supplies of Algerian gas to Europe when the country was engulfed in violence in the mid 1990s but such threats failed to materialize: true one incident due to a "terrorist" explosion did cut the flow of gas to Italy for a few days in 1997 but no terrorist group ever got near the exporting facilities in Arzew and Skikda or into a compressor station on the gas pipelines.

Today however, as a result of the tensions which have arisen with Russia, some hard questions are being asked about the policy of North Africa's largest country, 97% of whose foreign income

is derived from the export of oil and gas. Such questions focus on its overall hydrocarbons' policy and more particularly on its gas policy, its broader foreign policy, its overall domestic policy and how the oil and gas sectors are managed internally.

■ **Algeria is the Oldest Exporter of Liquefied Natural Gas (LNG) in the World**

The first commercial Liquefied Natural Gas (LNG) ships plied their trade in 1963 between Arzew and Canvey Island in the estuary of the Thames. That trade came to an end in October 1981 as the United Kingdom became self sufficient in energy but started again to Isle of Grain terminal in 2005. Gas Natural brought the first shipments of Algerian LNG into Barcelona in 1969 though the formal agreement between the two countries to trade LNG was only signed in 1972. Ever since those early years Algeria's Sonatrach has continued investing in gas fields, transport and export. Two pipelines across the Mediterranean have linked the Algerian gas fields with Europe: the Enrico Mattei gasline to Italy via Tunisia and since 1983 the Pedro Duran Farell gasline to Spain and Portugal via Morocco since 1996. Two new underwater gas lines are to be built. One, Medgaz, will link Beni Saf in Western Algeria to Almería in southern Spain: commissioning is expected this year (2009). The company has five shareholders – Sonatrach with 36% of the capital, Cepsa and Iberdrola with 20% each, Endesa and the newly merged GDF Suez with 12% each. The second pipeline, Galsi will link Skikda to Italy via Sardinia and Corsica.

These projects are subject to the usual commercial and financial haggling but we know they will be built. LNG is exported to Spain, Portugal, France, Belgium, Italy, Greece, Slovenia, Turkey, and the UK and of course, the US. Accidents have occurred, sabotage once but the extraction, storage, transport and export facilities that exist today in Algeria are far better managed and maintained than anything Russia has to offer. Foreign companies from many countries have been working with Sonatrach for decades and despite the ups and downs, both parties have done a remarkable job of extracting and transporting gas safely. Why would the leaders of Sonatrach have invested such large sums of money over 45 years if they had not decided that they wanted strong links with Europe? Would those who take the key decisions with regard to Algeria's foreign policy ever risk the credibility they have built up over half a century to be compromised? The answer surely is: probably not.

A Combination of Pipelines and LNG Gives Flexibility to Algeria's Export Policy

The building of two new pipelines and of further LNG facilities in Arzew and Skikda will increase Algeria's export flexibility. By the beginning of next decade, Sonatrach should have the capacity to export some 90bcm which could be further increased to some 110-120 bcm after 2020.

Reliability and credibility are thus backed up by strong infrastructure and the fact is that the flow of gas has never been interrupted for commercial, technical, political reasons or on account of terrorism. This is not to say that Algeria is always an easy partner, nor does it imply that there never will be any social or political turbulence in Algeria. Simply put Algeria and its leaders have not indulged in the bully tactics the Russians have resorted to from late.

Algeria does not face the same transit problems for its gas as Russia does. Pipelines are built within completely different institutional and political frameworks. Until a decade ago, Ukraine and Belarus were members of the former USSR and therefore not considered transit countries. Moreover in the former USSR the price of gas bore no relation to the cost of supply. One can understand that Russia should insist that neighbouring countries which are openly hostile should pay the same, commercial price for the gas they buy as other Western customers.

□ Algerian Gas Reserves are Large

As of today, Algeria has reserves estimated at 4,500bcm while gas to be discovered will add a further 1,500bcms to this figure but these figures are based on old estimates. Although Algeria has carried out an important exploration effort – 150 discoveries were made over the past twenty years – millions of square miles remain unexplored in areas which are geologically promising. By 2030 less than 40bcm out of an anticipated total of 200bcm of Algerian gas production will come from fields currently in production. Algeria's reserves are much greater than estimates made for Libya and Egypt although figures here also might be upped in the years to come. While Algeria has remained almost the only exporter of gas from the region for decades, Libya and Egypt are rapidly developing their sales as well.

Further developments could come in the form of a gas pipeline linking Nigeria with Algeria: such an idea might appear far fetched but this is neither the time nor the place to go into it. All of this points to Algeria retaining, alongside Norway and Russia, its role as one of the dominant energy suppliers to Europe in the years ahead. Various scenarios are being mapped out looking at the future gas corridors into Europe. North African producers, not least Algeria, have a lot to offer. In 2006, Russia exported 130 bcm to EU-27, Norway 84 bcm, North Africa 73 bcm – of which 57bcm was Algeria. The Observatoire Méditerranéen de l'Energie (OME) suggests that by 2030, future export potential to EU-27 could read as follows: Russia 207 bcm, Norway 110bcm and North Africa 181bcm of which Algeria accounts for 115bcm.

Algeria: A Strategic Gas Partner For Europe

Written by Francis Ghilès

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■ Algeria's Key Share in EU Gas Supply (In 2006 and 2030)

9 Main Gas Exporters to EU-27 in 2006

	2006		
Russia	42%		
Norway	27%		
	Algeria		18%
Nigeria	4%		
Libya	3%		
Egypt	3%		
Qatar	2%		
Oman	2%		
Trinidad	1%		

Estimated Main Gas Exporters to EU-27 in 2030

2030

Russia	29%		
	Algeria		16%
Norway	15%		
Qatar	11%		
Nigeria	6%		
Libya	5%		
Iran	5%		
Egypt	4%		
Caspian	2%		
Trinidad	1%		
Oman	1%		
Angola	1%		
Yemen	1%		
Others	3%		

Source : OME, Sophia Antipolis

The Supply Cost of Algerian Gas is Not Indifferent

The technical supply cost, excluding royalties, of new gas delivered to Europe from Algeria through the Medgaz and Galsi pipelines is about half as high as for new gas supplies from Russia and Norway. With the current high energy prices, the level costs do not really matter but should energy prices fall again to much lower levels, then suppliers with a lower cost structure will enjoy an important competitive advantage.

Algeria has benefited over the past two decades from cost reductions in LNG and to a lesser extent in pipeline projects. Since 2004 however, cost increases of up to 50%, mainly related to the costs of building greenfield liquefaction plants, have been easily offset by price increases. Investment funds have not so far proved to be a significant constraint: cost overruns and lack of available services have led to delays in implementing projects.

Following the events of 2006 and 2007, and 2009 many specialists argue that a political limit to Russian gas supplies to Europe is in sight and that the possibility of a limit being placed on Russian gas imports by European governments is not inconsistent with Russian export aspirations. Does Gazprom or its masters in the Kremlin really wish to export more than 200bcm a year? Does not future domestic demand already act as a barrier to this? The key long term uncertainty for Russian gas exports to Europe is the development of domestic demand which is subject to major uncertainties

It is worth noting that sufficient reserves exist in a number of countries within reach of European gas markets – Russia and North Africa, have been mentioned to which must be added Middle Eastern and Caspian suppliers not to mention a number of intercontinental LNG suppliers – to bring sufficient gas supplies to Europe to meet projected levels of import requirements and to diversify supply. As they talk enthusiastically of developing new sources of gas supply, particularly of pipeline gas from the Caspian/ Middle East region, European politicians seem to have little appreciation of the fact that such projects have been under consideration for 30 years with few results. This has less to do with resource and economic availability and more to do with the politics of crossing a large number of countries, many of which have difficult historical relationships.

According to Mustafa Faid, Director General of the Observatoire Méditerranéen de l'Energie Algeria, which is geographically close to the old continent has "proved to be a reliable supplier of gas for several decades and has the capacity to strongly develop its gas exports. The Medgaz pipeline, whose initial annual throughput capacity will be 8bn cubic metres, is a project which has moved from drafting board to implementation in a record length of time considering the size of the project, 90 months from its inception to the date when it starts carrying gas in mid 2009. This pipeline will offer Spain greater flexibility in the way it imports gas and help reinforce Europe's energy security. Indeed adding a few compressor stations would allow the capacity to be doubled, thus enabling the gas to reach other markets in the northern part of the Iberian Peninsula."

LNG is the new enemy of long distance, multi-country pipeline projects. The historical record hardly supports the argument that increasing import dependence should be automatically considered to be equivalent to decreasing supply security.

During the crisis of January 2006 the overwhelming conclusion of political and media comment was critical of Russia for exerting political pressure on Ukraine. There was no European censure of Ukraine for taking gas supplies to which it was not entitled, a clear indication of where European politicians felt the blame rested. Following the events in 2006, 2007, and 2009 some commentators have argued that a political limit to Russian supplies is in sight, that the political reaction to these disputes is not based on any analytical appraisal of European dependence on Russian gas or indeed the likely consequences of a supply disruption but rather based on a notion of security which, despite being purely psychological is arguably more important for policy formation than analyses of likely scenarios. The same commentators seem to have missed the important fact that Gazprom has long term contracts with some of its key foreign buyers such as Germany, France and Italy for another 15-20 years; these contracts are legally binding and subject to international arbitration with liquidated damages in the event of non-performance.

European Commentary

Much European commentary has focused on the general political and economic policies of governments as well as on the narrower gas policy frameworks which are believed to "threaten" European gas security. The new assertiveness of oil and gas producing countries in the wake of the post 2003 increase in prices, the widespread perception that such price levels will at least be a medium term phenomenon, the commercial challenges to both international oil and gas companies and OECD government policies in countries as geographically diverse as Venezuela, Russia, Iran not to mention Algeria, uncertainty about political stability in the Middle East and some African LNG exporting countries have been compounded by fears which stem from increased competition for energy exploration and development opportunities with Chinese and Indian companies. All these factors might have serious consequences for European gas

supplies. None of these tensions seems likely to be quickly resolved.

It is also worth putting discussion of a Gas-OPEC in context. Jonathan Stern of the Oxford Institute for Energy Studies has pointed out that such talk is a distraction from important issues of Russian and Algerian gas supply to Europe. The existing Gas Exporting Countries Forum (GECF) is a somewhat chaotic organisation with an unstable membership and an uncertain future if only because the interests of its members are so diverse: some are LNG exporters to the Pacific basin, others to the Atlantic basin; some are pipeline exporters to Europe, some are barely exporters at all; some are not exporters while some important exporting countries are not GECF members. Proposed gas cooperation between Russia and Algeria concern upstream investments and LNG projects rather than markets. Western commentators are keen to view all Russian foreign energy trade as “political” rather than commercial but it may well be appropriate to view relations with other gas exporters in this light.

Exporting countries such as Indonesia and Qatar, two of the world’s largest exporters of LNG are putting aside more and more gas for use in their domestic economies for power generation or for use in petrochemicals. To this dilemma must be added that of demand security. Gas is dependent on an expensive and rigid infrastructure for delivery – this binds buyer and seller closely as redirection of gas flow is difficult if not impossible. In oil, producers can add value by refining oil but gas-value is location specific. As gas markets become increasingly liberalized, gas exporters face increased uncertainty about their strategies. Markets are changing in ways that they really have little say over; hence the creation of the GECF.

Southern rim Mediterranean countries for their part have a very strong incentive to maintain continuous and secure deliveries to Europe if only because the income they earn is an essential component of their corporate, fiscal and national budgets. Furthermore, thirty years of Algerian politics and the relations between Algeria and its Western partners suggest that those who yield ultimate power in Algiers will not risk compromising their reputation for reliability in supplies that Sonatrach has built up over half a century. These same people are sophisticated and well understand the key importance of the psychological notion of security.

Europe Needs a New Gas Front

Algeria has an opportunity to strengthen its image as a reliable supplier of gas. A positive image however must be grounded in a smart appreciation of how to court European gas and electricity companies and governments. As Sonatrach seeks to move downstream into re-gasification and the transportation of gas, it should avoid giving the impression of bullying its European partners and seek joint ventures.

Suggestions from Algiers that it would like to sell gas under Sonatrach's name in Spain have not met with a friendly reception from the Spanish regulatory authorities who argue that the Algerian market is not sufficiently open: yet it would seem that Cepsa, Repsol and Gas Natural are enjoying considerable access upstream in developing new fields in Algeria. French and Italian authorities are reacting like their Spanish counterparts but not the British for whom energy patriotism is less important. The Algerian authorities might also bear in mind that they stand to gain from explaining any windfall taxes they deem necessary comprehensively and skilfully to Sonatrach's foreign partners rather than brutally imposing them: psychology matters here and Algiers sometimes plays a rough game of cards. Finally, long delays in reaching agreements also push up the costs of future developments and do not reflect well on Sonatrach.

Beyond these somewhat technical points both Sonatrach and Algerian leaders have to build a far more pro active policy towards the Western media if they are serious in their intent of burnishing their image with European public opinion. Today neither the country nor its oil and gas company have an image to speak of: will the country's leaders appreciate the opportunity that lies within their grasp? Will they understand that reference to a Gas OPEC confuses the issue and simply worries Western public opinion? Will they use gas to convince public opinion, European companies and leaders that they aspire to be a serious economic partner?

The Oxford University High-Level Task Force on Energy Security, Climate Change and Development stressed recently that "two challenges face Europe...and will define, not only the continent's future, but the world within which Europe exists in the 21st century: security and the reconciling of energy, climate change and economic development goals. To an increasing degree these challenges will interact – for instance in Europe's policies towards the Middle East and the Mediterranean, Africa and South Asia, and in the EU's relations with China and Russia."

Is the time not ripe for Europeans to realize that Algeria and beyond it, Libya, cannot simply be treated as a vast black hole from which we can pump gas? Is it not worth considering what the future possible benefits of a Nigeria-Algeria gas pipeline might entail for the development of Africa? Is there any chance that some of the European elite can come to appreciate that North African countries cannot continue to be treated with the mixture of condescension and cynicism they have been subject to in the past?

The answers brought from both sides of the Mediterranean to some of these questions will determine whether Algeria can build its current reputation as a reliable gas partner with Europe into a strategic partnership, one which would perforce include its neighbours in North Africa. Such a partnership would be both stronger and economically speaking, more diverse than the agreements between Northern and Southern rim countries which exist today. Would such a

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partnership not be well suited to the mounting challenge of the times we live in?

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